LEXXOR ENERGY INC.

profile | Lexxor is actively engaged in the acquisition, exploration, development and production of crude oil and natural gas, with operations in Western Canada. The Corporation acquires assets that have a strategic fit with existing operations or that represent significant upside in new project areas. Lexxor holds an average working interest of 64 per cent in over 167 thousand acres of land located in three core areas within Alberta and Saskatchewan. Lexxor acquires, explores for and develops reserves that can be tied in and marketed on a timely basis. Lexxor's common shares are listed and posted for trading on the Toronto Stock Exchange under the trading symbol "LXX".

Shareholder Meeting

The Annual and Special Meeting of Shareholders of Lexxor Energy Inc. will be held on Tuesday, June 10, 2003 at 2:30 p.m. (Calgary time) in the Bow Valley Conference Centre on the 3rd Floor, 205 - 5 th Avenue S.W. Calgary, Alberta. Shareholders who are unable to attend the Meeting are requested to complete and return the Form of Proxy to Valiant Trust Company.

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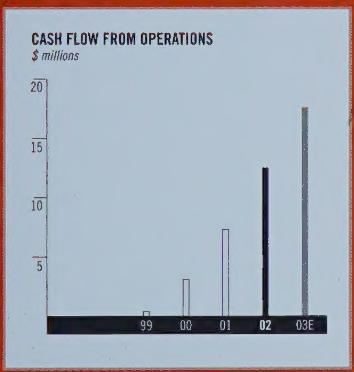
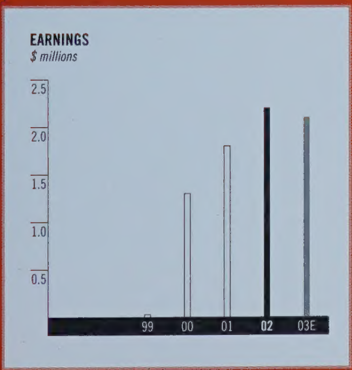
forward-looking statements | Corporate information provided herein contains forward-looking statements. The reader is cautioned that assumptions used in the preparation of such information, which are considered reasonable by Lexxor Energy Inc. at the time of preparation, may be proved to be incorrect. Actual results achieved during the forecast period will vary from the information provided and the variations may be material. There is no representation by Lexxor Energy Inc. that actual results achieved during the forecast period will be the same in whole or in part as those that are forecast.

Fast Facts — Lexxor Energy Inc. — TSX: LXX





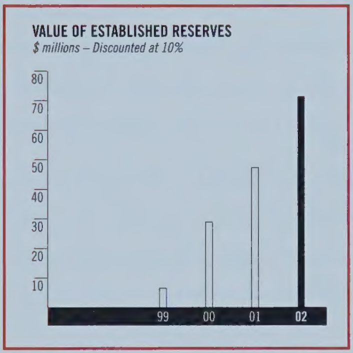
For the fourth consecutive year, Lexxor posted significant increases in production, reserves, undeveloped land, revenues, cash flow and earnings in 2002. Since 1999, the management of Lexxor has grown a solid and profitable oil and gas company through successful acquisition, exploration and development strategies. This past year was no exception with the acquisition of Liberty Oil & Gas Ltd. ("Liberty") in July. Combined with new exploration and development activities, the acquisition of Liberty will position our Company for further growth during 2003.

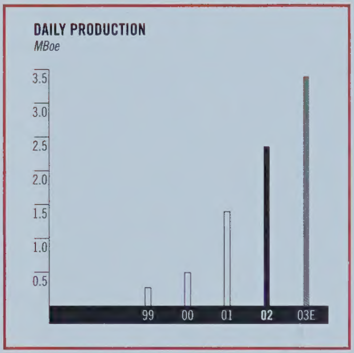
A Strategic Plan

Objectives

- Increase reserves & production in 3 core areas
- Increase cash flow and earnings
- Achieve rapid & sustained growth
- Increase share price

Performance



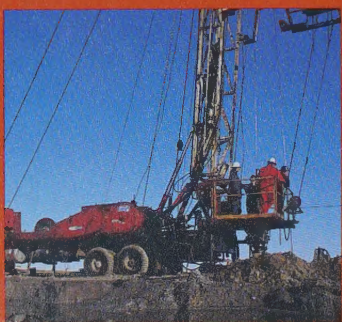


Implementation

Lexxor intends to maintain a capital expenditure budget in 2003 of $12.6 million.

- **Acquisitions** – During 2002, the $23.8 million acquisition of Liberty in July was a significant factor in the Company's ability to post increases in production, reserves, undeveloped land, and revenues. Lexxor is also continuing to review opportunities to augment its growth through selective acquisitions.
- **Exploration** – Lexxor has undertaken a thorough review of its exploration program and currently has a strong prospect inventory to draw from with 34 exploratory locations identified. The Company had flow-through expenditure commitments of $4.9 million remaining as of December 31, 2002, all of which will be spent on exploratory seismic and drilling prior to December 2003. A $1 million seismic program within Lexxor's three core areas has commenced with the planned shooting of five proprietary 3-D programs.
- **Development** – 59 development drilling locations are presently identified within Lexxor's three core areas. During 2002, 57% of Lexxor's drilling program of 42 wells were development wells, compared to 84% in 2001. During 2003, Lexxor plans to exploit the Liberty assets through development drilling. The majority of the development drilling is scheduled for summer and fall to take advantage of lower costs and quick tie-in to markets.

Fast Facts — Lexxor Energy Inc. — TSX: LXX



A cyclic pricing environment:

Commodity price cycle volatility reflects the changing external business environment that exploration and production companies continue to face. As supply and demand react to each other, external events and trends influence and shape the price cycles. During 2002, price volatility was significantly influenced by concerns about near-term supplies of crude oil and near to long-term supplies of natural gas.

December 31 (000, except share amounts)		**2002**	2001	2000	1999
FINANCIAL					
Petroleum and natural gas sales		**28,465**	16,362	6,632	1,807
Cash flow from operations		**12,455**	7,345	3,110	357
Per share -diluted		**0.73**	0.66	0.50	0.10
Earnings		**2,174**	1,807	1,340	15
Per share - diluted		**0.13**	0.16	0.21	0.00
Net capital additions		**40,673**	24,900	13,524	411
Debt and working capital deficiency		**30,081**	16,216	4,638	1,623
Shareholders' equity		**31,453**	17,321	10,191	1,045
Total assets		**79,871**	46,476	21,095	3,875
Operating netback - per Boe		**18.77**	18.06	22.61	8.96
Cash netback - per Boe		**14.40**	13.94	16.83	3.61
Common shares outstanding - 04/18/03		**20,818,402**			
Shares issuable upon exercise of warrants		**2,378,451**			
Stock Options		**1,736,000**			
OPERATING					
Production					
Oil and NGLs (Bbls/d)		**1,825**	1,065	211	79
Natural gas (Mcf/d)		**3,189**	1,983	1,696	1,151
Oil equivalent (Boe/d)		**2,357**	1,395	494	271
Average selling price					
Crude oil and NGLs ($/Bbl)		**35.89**	32.37	41.77	22.55
Natural gas ($/Mcf)		**4.54**	5.30	5.58	2.75
Oil equivalent ($/Boe)		**33.94**	32.24	37.01	18.26
Established reserves [(1)]					
Oil and NGLs (MBbls)		**5,231**	3,767	1,654	631
Natural gas (MMcf)		**10,751**	6,539	5,993	3,203
Oil equivalent (MBoe)		**7,024**	4,857	2,653	1,165
Present value of reserves ($M) [(1)]					
(discounted at 10% before tax)		**71,428**	47,259	28,911	6,530
Recycle ratio		**1.1**	1.9	2.8	11.6
Reserve replacement ratio		**3.5**	4.3	8.3	4.5
Reserve replacement costs ($/Boe)		**13.44**	9.17	8.10	0.77
Reserve life index (years)		**8.2**	9.5	14.7	11.8
Wells drilled	Gross	**42.0**	43.0	18.0	8.0
	Net	**27.8**	26.6	10.5	3.7
Land holdings	Gross acres	**167,483**	117,271	75,599	54,785
	Net acres	**107,140**	64,422	30,066	19,218
	Average working interest	**64%**	62%	58%	46%

(1) *GLJ Report effective January 1, 2003 using GLJ April 1, 2003 escalated price forecast.*

President's Report to the Shareholders of Lexxor

Countering the trend:

Faced with uncertainty about the sustainability of commodity prices and massive economic and political instability on the world stage, many energy players stepped back from drilling and other activities during the second half of the year. Lexxor maintained its vision, discipline and pursuit of careful growth and continued to pursue the balanced acquisition, exploration, and development strategy that allowed us to post our fourth consecutive record year.

In 2002, Lexxor Energy countered the "wait and see" trend within North America's energy industry, and continued to pursue the balanced acquisition, exploration, and development strategy that allowed us to post our fourth consecutive record year.

Faced with uncertainty about the sustainability of commodity prices and massive economic and political instability on the world stage, many energy players stepped back from drilling and other activities during the second half of the year.

At Lexxor, we maintained our vision, discipline and pursuit of careful growth. Our $23.8 million acquisition of Liberty Oil & Gas Ltd. ("Liberty") in July was a significant factor in helping us realize increases in production, reserves, undeveloped land, revenues, cash flow and earnings during the year. Equally significant was our unswerving commitment to laying even stronger foundations for growth in 2003.

Achieving Results through Acquisition and Performance

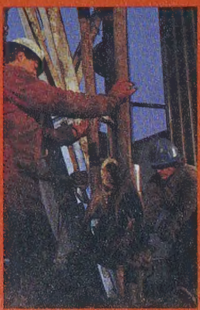
Lexxor acquired Liberty through a plan of arrangement on July 23, 2002, and commenced trading on the Toronto Stock Exchange on July 26, 2002. This enabled our Company to raise $16.6 million of new equity through the sale of common shares and flow-through common shares, and the issuance of common shares to the shareholders and creditors of Liberty.

The Liberty acquisition contributed substantially to our Company's ability to increase our overall production by 69 per cent during the year, and petroleum and natural gas sales by 74 per cent, to $28.5 million from $16.4 million in 2001. Cash flow from operations increased 70 per cent to $12.5 million from $7.3 million in 2001, and earnings rose 20 per cent to $2.2 million from $1.8 million in 2001.

As well, throughout the year, Lexxor:

- Increased established reserve volumes by 45 per cent after production to 7 million barrels of oil equivalent, compared to 4.9 million in 2001, as determined by our independent engineers, Gilbert Lausten Jung Associates Ltd. This growth replaced 2002's production by 3.5 times. Established reserve value (PV10 before tax) increased 51 per cent to $71.4 million from $47.3 million.
- Increased average daily production to 2,357 barrels of oil equivalent per day compared to 1,395 in 2001, 494 in 2000 and 271 in 1999. Exit production on December 31, 2002, increased 50 per cent to 3,000 barrels of oil equivalent (65 per cent oil, 35 per cent natural gas), compared to 2,000 barrels of oil equivalent (85 per cent oil, 15 per cent natural gas) on December 31, 2001.
- Increased total net land holdings by 66 per cent to 107,140 net acres in 2002. Undeveloped lands, valued at $4.9 million by Seaton-Jordan & Associates Ltd., increased 60 per cent to 76,355 net acres from 47,730 net acres in 2000.
- Achieved strong financial and operating results during fourth quarter 2002, positioning our Company for further growth during 2003. Fourth quarter 2002 production averaged 45 per cent to 2,900 barrels of oil equivalent per day, compared to fourth quarter 2001 production of 2,002 barrels of oil equivalent per day. Fourth quarter 2002 cash flow from operations doubled to $4.2 million from $2.1 million in 2001 as a result of increased production and strong commodity prices.

President's Report to the Shareholders of Lexxor



On commodity prices:

Commodity price cycle volatility reflects the changing external business environment that exploration and production companies continue to face. As supply and demand react to each other, external events and trends influence and shape the price cycles. During 2002, price volatility was significantly influenced by concerns about near-term supplies of crude oil and near- to long-term supplies of natural gas.

- Increased net asset value by 36 per cent to $53.2 million, compared to $39.4 million in 2001, $28.7 million in 2000 and $6.4 million in 1999. Net asset value of $2.35 per diluted share was down 14 per cent from $2.73 per diluted share in 2001, reflecting an 18.4 per cent downward revision to prior years' established reserves and a 58 per cent increase in the diluted number of shares outstanding in 2002.

ANTICIPATING MORE PRICE VOLATILITY

The past year was characterized by extreme volatility in oil and gas prices. Crude oil prices averaged $19.73 US per barrel in January and increased by year end to average $29.38 US per barrel in December. The average price in 2002 for West Texas intermediate crude oil was $26.08 US per barrel, the second highest average since 1990. Canadian natural gas spot prices opened the year at $3.18 per thousand cubic feet, increased to over $5.00 in April and declined to $1.28 in July. Prices rallied to $6.33 in December and closed the year at $5.70 per thousand cubic feet. The average price for the year at $4.07 per thousand cubic feet was 35 per cent lower than 2001.

Commodity price cycle volatility reflects the changing external business environment that exploration and production companies continue to face. As supply and demand react to each other, external events and trends influence and shape the price cycles. During 2002, price volatility was significantly influenced by concerns about near-term supplies of crude oil and near- to long-term supplies of natural gas.

The fourth quarter rally in oil prices resulted from a combination of supply disruptions associated with civil unrest in Venezuela and concern over a possible war in Iraq. We expect that oil price volatility will continue until these situations are resolved and have assumed an average $25.00 US per barrel for 2003 in our forecast.

The current strength in natural gas prices is directly associated with below normal inventory levels and concern about the North American natural gas industry's ability to replace production on an on-going basis. High natural gas prices have occurred despite the dampening of demand caused by the prolonged slow growth of the United States economy. Improved performance in that economy should increase demand, causing further strain in an already tight natural gas market. As a result, our forecast calls for an average natural gas price of $4.55 per thousand cubic feet during 2003 – although the possibility exists for higher actual prices due to strong fundamentals.

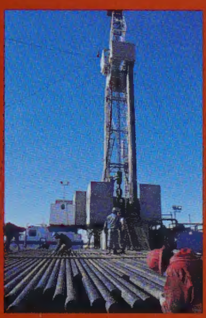
GROWING OUR PRODUCTION BASE

Lexxor's production increased 69 per cent to 2,357 barrels of oil equivalent per day from 1,395 in 2001. Production consisted of 3,189 thousand cubic feet per day of natural gas, and 1,825 barrels per day of oil and natural gas liquids.

During the first six months of 2002, our drilling program replaced natural declines inherent in our three core areas of operation. The significant increase in production in the second half of the year was primarily due to the acquisition of Liberty in July 2002, allowing us to achieve our original exit production target of 3,000 barrels of oil equivalent per day.

We anticipate a higher natural gas contribution towards our 2003 forecast of 3,400 barrels of oil equivalent per day as a result of increased drilling for natural gas, with natural gas accounting for approximately 36 per cent of the total, up from 23 percent in 2002.

President's Report to the Shareholders of Lexxor



On Volume growth:

Lexxor's production increased 69 per cent to 2,357 barrels of oil equivalent per day from 1,395 in 2001. Production consisted of 3,189 thousand cubic feet per day of natural gas, and 1,825 barrels per day of oil and natural gas liquids.

ADDING TO RESERVES

Lexxor increased its total established reserves during 2002, after production, by 45 per cent to 7.0 million barrels of oil equivalent from 4.9 million in 2001. Proved plus probable reserves totaled 8.2 million barrels of oil equivalent, up 60 per cent from 5.1 million in 2001.

Lower than expected reserve additions resulted from 2002's drilling program, mainly due to a lack of exploratory success. Forty three per cent of the wells drilled by our Company during 2002 were classified as exploratory wells, versus only 16 per cent exploratory during 2001. Our stated objective in 2002 of pursuing natural gas prospects in west central Alberta was met with only moderate success. Further work in this area is required to fully evaluate its potential for significant reserve additions.

CAPITAL ADDITIONS AND REPLACEMENT COSTS

During 2002, Lexxor participated in 24 development wells and 18 exploration wells for an overall success rate of 79 per cent. Our Company was the operator of 27 of the 42 wells and maintained an average 66 per cent working interest.

Overall reserve replacement costs of $13.44 per barrel of oil equivalent were significantly higher than the $9.17 per barrel of oil equivalent in 2001. Downward revisions to prior years' reserves and lack of exploratory success resulted in lower than expected reserve additions for the year. The Liberty acquisition somewhat offset our disappointing drilling results by adding established reserves at $8.26 per barrel of oil equivalent. Our higher replacement costs during 2002 resulted in a recycle ratio for established reserves of 1.1, indicating our Company generated an equivalent value from reserves added versus the cost to replace them. We anticipate decreased replacement costs during 2003 as a result of targeting larger reserve prospects, strict capital cost controls and fewer negative revisions to prior years' reserves. As a result, the recycle ratio is expected to return to a healthier level in 2003.

Cash flow of $12.5 million exceeded our original forecast of $11 million. However, this was achieved with a much greater expenditure of capital at $40.7 million, net of dispositions, compared to $11.5 million in our original forecast. The substantial increase in capital spending enabled us to complete the $23.8 million Liberty acquisition based on a low cost of financing, a very affordable and attractive asset package, and an immediate production increase of approximately 1,000 barrels of oil equivalent per day. We were also able to expand our exploration efforts in several key areas, laying the groundwork for a number of our future prospects.

LOOKING AHEAD

In January 2003, we announced the initiation of a shareholder maximization process. Our share price of $1.70 at year-end 2002 was not what we expected in light of our growth during the year and the underlying value of our assets. Our shares continue to trade at a low multiple of cash flow and below the multiples being afforded to our peer group of companies.

We don't accept our Company's share price performance in 2002 because we know Lexxor is capable of doing better. CIBC World Markets Inc. has been retained to assist us with a process of reviewing alternatives for maximizing shareholder value, which has included the invitation to other companies to come forward and discuss a possible transaction.

President's Report to the Shareholders of Lexxor

Success is often serendipitous:

Notwithstanding lower than expected reserve additions from the 2002 drilling program, Lexxor increased its total established reserves during 2002, after production, by 45 per cent to 7.0 million barrels of oil equivalent from 4.9 million in 2001. Proved plus probable reserves totaled 8.2 million barrels of oil equivalent, up 60 per cent from 5.1 million in 2001.

We have undertaken a thorough review of our exploration and development program. Lexxor has a strong prospect inventory to draw from, with 34 exploratory and 59 development locations presently identified. To augment our exploration and development program, we are also pursuing opportunities to grow through selective corporate and asset acquisitions. Of a total of 93 prospects, 40 are drill-ready, including 24 that have been identified by our independent engineers. Within the prospect list are several high-risk, high-reward opportunities. These include a Devonian pinnacle reef light oil play, a subcrop edge Elkton gas play, and an aerially extensive upper Mannville gas play.

In early 2003, Lexxor acquired 1,134 (851 net) acres of deep rights in the Viewfield area of southeast Saskatchewan. Using three-dimensional seismic, our exploration group has identified several Devonian Winnipegosis pinnacle reef targets at our Viewfield property, which is located approximately ten kilometers north of the nearest Winnipegosis light oil production at Benson. An exploratory drilling location is being planned for the second quarter of 2003 as soon as field conditions permit entry. A well will be drilled to a depth of 2,300 metres to test the largest of the reef anomalies.

After spring breakup, our Company plans to begin a low-risk oil development drilling program that will include two wells at Neutral Hills in Alberta, one well at Fosterton in southwest Saskatchewan, and wells at Ingoldsby and Antler West in southeast Saskatchewan.

Following up on a fourth quarter 2002 light oil discovery at Antler West, our exploration group completed a three-dimensional seismic survey on offsetting lands during the first quarter of 2003. An attractive Tilston anomaly will be tested with a vertical well and, if successful, a horizontal well will be drilled. On the natural gas side, we expect to test prospects at Gooseberry, Dobson and Veteran in our east central core area and at Thorsby in west central Alberta.

We intend to maintain a reduced capital expenditure budget in 2003 of $12.6 million to drill 30 locations. Lexxor had flow-through expenditure commitments of $4.9 million remaining as of December 31, 2002. These will be satisfied through exploratory seismic and drilling expenditures prior to December 2003.

Efforts will be made to reduce our debt to cash flow ratio during 2003. We expect to direct approximately $5.0 million of cash flow, surplus to our capital needs, towards debt repayment during the year. Bank debt is projected to be approximately $25 million at year end, resulting in a debt to cash flow ratio of 1.4:1. At the present time, crude oil and natural gas prices continue to be higher than the average prices assumed in our 2003 budget. Should these strong prices continue, the additional cash flow generated will be allocated to further debt reduction.

During 2002, we sold approximately $2.1 million worth of non-core assets. A number of additional non-core properties remain under consideration for sale. Funds raised through these selective divestitures will be used for debt repayment or to enhance our on-going exploration and development activities. A renewed focus on a strengthening of our balance sheet may seem like a conservative strategy to some shareholders, but this focus may prove to be prudent as market realities unfold.

President's Report to the Shareholders of Lexxor

Committed to our shareholders:

Lexxor has a strong team and a proven track record that will continue in the volatile commodity price environment expected over the foreseeable future. We are committed to maintaining a disciplined approach to our business. A sound acquisition, exploration, and development strategy, combined with a solid financial structure, will underpin our goal of adding value for our shareholders.

Lexxor expects to average 3,400 barrels of oil equivalent per day during 2003, an increase of 44 per cent from 2002. Production from existing properties is expected to average 2,730 barrels of oil equivalent per day while discoveries and extensions are expected to add approximately 670 barrels of oil equivalent per day to our Company's 2003 average. Cash flow is expected to be approximately $17.6 million ($0.85 per share basic) based on conservative prices of $25.00 US per barrel for crude oil, and $4.55 per thousand cubic feet for natural gas. The following table shows our Company's cash flow sensitivities due to pricing and volume changes to the 2003 forecast.

2003 CASH FLOW SENSITIVITIES

	Forecast	Change of	Cash Flow	Per Share
Crude oil and NGLs:	2,176 Bbl/d	100 Bbl/d	$ 762,000	$ 0.03
	$ 25 US/Bbl	$ 1 US/Bbl	$ 849,000	$ 0.04
Natural gas:	7,344 Mcf/d	1,000 Mcf/d	$ 746,000	$ 0.03
	$ 4.55/Mcf	$ 0.25/Mcf	$ 489,000	$ 0.02

Lexxor has a strong team and a proven track record that will continue in the volatile commodity price environment expected over the foreseeable future. We are committed to maintaining a disciplined approach to our business. A sound acquisition, exploration, and development strategy, combined with a solid financial structure, will underpin our goal of adding value for our shareholders.

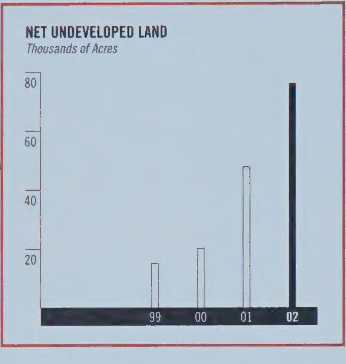
We intend to continue to work hard on your behalf, and appreciate your on-going support and confidence in our efforts. We also wish to express our appreciation for the loyalty shown by our customers and business partners, and for the dedication and commitment of our employees.

Our success would not be possible without the support, guidance and advice of Lexxor's Board of Directors. On behalf of the management team at Lexxor, I extend our thanks.

DOUGLAS O. MCNICHOL
President and Chief Executive Officer

April 17, 2003

Review of Operations



Land and Seismic

Lexxor's undeveloped oil and gas lands were independently evaluated by Seaton-Jordan & Associates Ltd. ("Seaton-Jordan") as at December 31, 2002. Seaton-Jordan assigned a value of approximately $4.9 million to the Company's undeveloped land, compared to $3.8 million as of December 31, 2001. In addition, Lexxor has an exclusive option to earn leases through drilling involving approximately 36,000 net acres of Talisman Fee Title Lands in southeast Saskatchewan. This option expires March 2004.

This large land portfolio contains an inventory of drill-ready prospects with significant reserve potential, covered by a proprietary and trade 2-D and 3-D seismic database with an internally estimated replacement value of $2.6 million.

The following table summarizes the developed and undeveloped working interest acreage held by Lexxor as at December 31, 2002.

	Undeveloped			Developed			Total[3]		
Acres	Gross[1]	Net[2]	Average Interest	Gross[1]	Net[2]	Average Interest	Gross[1]	Net[2]	Average Interest
East Central	44,213	33,415	76%	38,304	20,578	54%	82,517	53,993	65%
SE Saskatchewan	32,313	27,962	87%	9,450	6,051	64%	41,763	34,013	81%
West Central	35,363	14,978	42%	7,840	4,156	53%	43,203	19,134	44%
Total[3]	111,889	76,355	68%	55,594	30,785	55%	167,483	107,140	64%

(1) *Gross acres refer to the total acres in which Lexxor has an interest.*
(2) *Net acres refer to the total acres in which Lexxor has an interest multiplied by the percentage working interest owned by Lexxor.*
(3) *Does not include Talisman Fee Title Lands.*

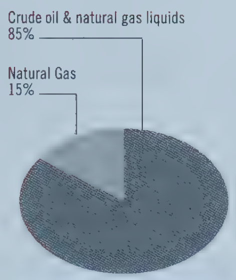
Drilling Activity

The following table shows the number of gross and net exploratory and development wells in which Lexxor has participated in drilling for the four years ended December 31.

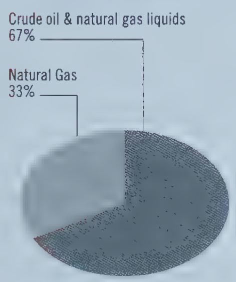
	2002		2001		2000		1999	
Year Ended December 31,	**Gross[1]**	**Net[2]**	Gross[1]	Net[2]	Gross[1]	Net[2]	Gross[1]	Net[2]
Oil	**28**	**18.14**	32	18.28	11	8.53	1	0.65
Gas	**5**	**3.35**	4	2.83	2	0.41	6	2.77
Dry	**9**	**6.31**	7	5.52	5	1.57	1	0.25
Total	**42**	**27.80**	43	26.63	18	10.51	8	3.67
Exploratory[3]	**18**	**12.81**	7	5.89	11	5.33	6	2.54
Development[4]	**24**	**14.99**	36	20.74	7	5.18	2	1.13
Total	**42**	**27.80**	43	26.63	18	10.51	8	3.67

(1) *Gross wells means the number of wells in which Lexxor owns a working interest.*
(2) *Net wells means the aggregate of the percentage working interests of Lexxor in the Gross wells.*
(3) *An Exploratory well, in general, is a well drilled either in search of a new and as yet undiscovered pool of oil or natural gas, or with the expectation of significantly extending the limits of a pool which is partly delineated.*
(4) *A Development well, in general, is a well drilled within or in close proximity to a discovered pool of oil or natural gas.*

Review of Operations



2001 exit product mix



2002 exit product mix

In comparison to drilling 42 wells (27.8 net) during 2002, Lexxor intends to drill 30 wells (20 net) during 2003. Drilling activities during the year added 1,035.6 MBoe of established reserves, lower than original expectations. Forty three per cent of the wells drilled by Lexxor during 2002 were classified as exploratory wells versus only sixteen per cent exploratory during 2001.

Lexxor has over 90 drilling locations in its prospect portfolio on a land base of 107,140 acres of land in Alberta and Saskatchewan. These prospects are supported by 2-D and 3-D seismic and 24 of these locations were included in the year end reserve report prepared by Gilbert Laustsen Jung Associates Ltd. Lexxor's 2003 capital budget includes $12.6 million of net capital additions, of which $5.0 million will be spent on exploratory seismic and drilling.

Production

All of the Corporation's crude oil, natural gas liquids, and natural gas production is derived from Alberta and Saskatchewan. During 2002, the Corporation's total production of 860.2 MBoe (2,357 Boe/d), was comprised of 1,825 Bbl/d of oil and NGLs and 3,189 Mcf/d of natural gas. The following table provides comparative production volumes for the past four years.

Average Daily Production:

	2002	2001	2000	1999
Crude oil and NGLs (Bbl/d)	**1,825**	1,065	211	79
Natural gas (Mcf/d)	**3,189**	1,983	1,696	1,151
Oil Equivalent (Boe/d)	**2,357**	1,395	494	271

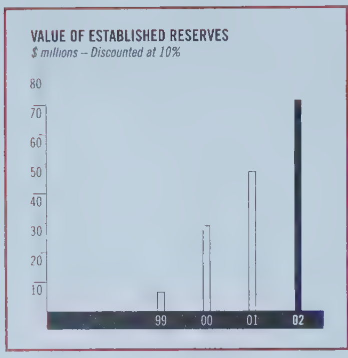
Activities during 2002 increased the Corporation's natural gas production by 18 per cent compared to 2001 exit rates, primarily due to the acquisition of Liberty in July 2002 and discoveries at Whitecourt in the west central core area.

Oil, Natural Gas and NGL Reserves

Lexxor's reserves were evaluated by the independent engineering firm of Gilbert Laustsen Jung Associates Ltd. ("GLJ"). GLJ were previously the independent engineers of Liberty and evaluated Liberty's properties effective January 1, 2002. In late 2002 Lexxor commissioned GLJ to prepare an independent reserves appraisal and economic evaluation of its corporate reserves including the properties acquired through the Liberty transaction. GLJ has completed an independent reserves determination before income tax analysis of Lexxor's oil and gas properties effective January 1, 2003 ("the GLJ Report").

During 2002, Lexxor increased its total established reserves, after production, by 45% to 7,024 MBoe from 4,857 MBoe (6:1) in 2001. Proved plus probable reserves totaled 8,162 MBoe, up 60% from 5,091 MBoe in 2001. The growth in established reserves replaced 2002's annual production of 860 MBoe by 3.5 times. On March 17, 2003, at the Company's request, GLJ prepared updated cash flow projections for Lexxor properties effective January 1, 2003 using the GLJ April 1, 2003 Price Forecast. The following table provides reserve information by category.

Review of Operations



Reserves and Cumulative Cash Flow Values Based on Escalated Prices and Cost Assumptions

	Reserves			Net Present Value Before Income Tax			
	Oil	Gas	NGLs	$million – Discounted at			
January 1, 2003	MStb	MMcf	MStb	0%	10%	15%	20%
Proved producing	3,298	6,806	151	70.5	51.5	46.1	42.0
Proved non-producing	745	2,367	163	20.8	12.0	9.8	8.2
Total proved	4,043	9,173	314	91.3	63.5	55.9	50.2
Probable	1,647	3,157	103	34.2	15.8	12.0	9.5
Proved plus probable	5,690	12,330	417	125.5	79.3	67.9	59.7
Less 50% probable	825	1,580	53	17.1	7.9	6.0	4.9
Proved plus 50% probable	4,866	10,751	365	108.4	71.4	61.9	54.9

Price Forecasts

The following table shows the GLJ April 1, 2003 escalated price forecasts prepared by GLJ.

	Crude Oil ($US/Bbl)(1) GLJ Escalated Apr 1/03	Natural Gas ($Cdn/MMBtu)(2) GLJ Escalated Apr 1/03
2003	30.75	6.60
2004	25.00	5.45
2005	23.00	5.05
2006	23.00	5.05
2007	23.00	5.05

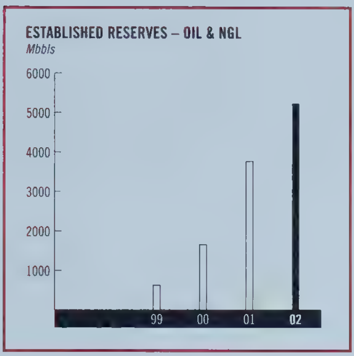
(1) *West Texas Intermediate at Cushing, Oklahoma*
(2) *AECO-C Spot*

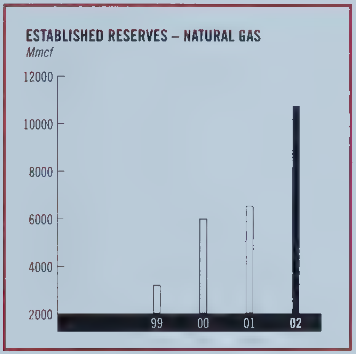
Reserve Reconciliation

Changes in reserves during 2001 and 2002 are outlined in the following Reserve Continuity Summary. Significant reserves were added in July 2002 when Lexxor closed the Liberty acquisition.

The year-end evaluation by GLJ brought Lexxor's reserves under one evaluator and the revisions reflected in part the current move within the industry to more stringent evaluation standards. Production performance and differences in proved undeveloped drilling assignments were the main reasons for the negative revisions. Crude oil reserves were reduced at Antler, Edenvale and Ingoldsby in Saskatchewan and natural gas reserves were reduced at Monitor and Nisku in Alberta. Downward revisions to prior years' established reserves totaled 892.8 MBoe or 18.4%. Lower than expected reserve additions resulted from the 2002 drilling program, mainly due to a lack of exploratory success. The Company's stated objective in 2002 of pursuing natural gas prospects in west central Alberta was met with only moderate success.

Review of Operations





Reserve Continuity Summary

(MBoe)	Proven	Probable	Established
December 31, 2000	2,181.4	943.0	2,652.9
Discoveries/extensions	1,736.7	72.0	1,772.7
Acquisitions/divestitures	1,417.8	0.0	1,417.8
Production	(509.3)	0.0	(509.3)
Revisions	(202.8)	(548.0)	(476.8)
December 31, 2001	4,623.8	467.0	4,857.3
Discoveries/extensions	929.5	212.1	1,035.6
Acquisitions/divestitures	2,342.5	1,083.2	2,884.1
Production	(860.2)	0.0	(860.2)
Revisions	(1,149.6)	513.7	(892.8)
December 31, 2002	**5,886.0**	**2,276.0**	**7,024.0**

Capital Expenditures and Reserve Replacement Costs

Capital expenditures and reserve replacement costs for the most recent three-year period are shown in the following table. Reserve replacement costs in 2002 at $13.44 /Boe established ($19.16/Boe proved and $10.35/Boe proved + probable) were significantly higher than in 2001. Downward revisions to prior years' reserves increased reserve replacement costs by $3.06/Boe established ($6.73/Boe proved and $1.44/Boe proved + probable). Lexxor's average replacement costs (including revisions) during the most recent three-year period were $10.67/Boe established ($12.30/Boe proved and $9.43/Boe proved + probable)

Lexxor's higher replacement costs during 2002 resulted in a recycle ratio for established reserves of 1.1 indicating the Company generated an equivalent value from reserves added versus the cost to replace them. Lexxor anticipates decreased replacement costs during 2003 as a result of targeting larger reserve prospects, strict capital cost controls and fewer negative revisions to prior years' reserves. As a result the recycle ratio is expected to return to a healthier level in 2003.

Capital Expenditures and Reserve Replacement Costs

($000)	3 Yr.Total	**2002**	2001	2000
Lease rentals and acquisition	2,703	**1,260**	1,349	94
Geological and geophysical expenditures	2,457	**1,146**	1,148	163
Drilling & completions	22,526	**11,128**	8,388	3,010
Equipment and facilities	10,177	**3,742**	4,592	1,843
Acquisitions/divestitures	37,855	**22,121**	7,724	8,010
Capitalized G&A and other costs	3,379	**1,276**	1,699	404
Total capital expenditures	79,097	**40,673**	24,900	13,524
Net change in established reserves after production (MBoe)	5,861	**2,167**	2,206	1,488
Annual production (MBoe)	1,549	**860**	509	180
Annual reserve additions (MBoe)	7,410	**3,027**	2,715	1,668
Annual acquisition, finding and development costs ($/Boe)	10.67	**13.44**	9.17	8.10

Review of Operations

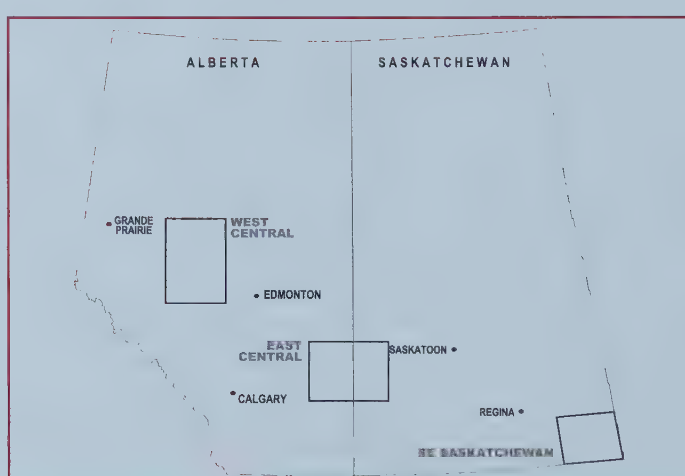
Areas of Operation

All of the Corporation's crude oil, natural gas liquids, and natural gas production is from three core areas including Southeast Saskatchewan, East Central (Alberta/Saskatchewan), and West Central (Alberta). The following table sets forth the key assets within each area of Lexxor's operations for the year ended December 31, 2002.

	Southeast Saskatchewan	East Central	West Central	Total
Net acres of land[1]				
Developed	6,051	20,578	4,156	30,785
Undeveloped	27,962	33,415	14,978	76,355
Total	34,013	53,993	19,134	107,140
Average Daily Production				
Crude oil & NGLs (Bbl/d)	887	888	50	1,825
Natural gas (Mcf/d)	47	2,085	1,057	3,189
Oil equivalent (Boe/d)	895	1,236	226	2,357
Established Reserves[2]				
Crude oil & NGLs (MStb)	2,746	2,381	104	5,231
Natural gas (MMcf)	839	7,074	2,838	10,751
Oil equivalent (MBoe)	2,886	3,561	577	7,024
Value of Established Reserves (PV10 $000)[2]				
Proven	23,644	33,302	5,881	62,827
Probable (risked @ 50%)	3,490	3,827	513	7,830
Sub-Total	27,134	37,129	6,394	70,657
ATRC & Adjustments				771
Total				71,428

(1) *In addition, Lexxor holds an exclusive option to earn leases by drilling wells involving approximately 36,000 net acres of Talisman Energy Inc. Fee Title Lands in southeast Saskatchewan.*

(2) *Established reserves are defined as proven reserves plus probable reserves risked at 50%. For 2002, the determination of Lexxor's established reserve value is based on the GLJ Report effective January 1, 2003 using GLJ's April 1, 2003 escalated price forecast.*



Review of Operations

Southeast Saskatchewan

The following table sets forth the historical development of Lexxor's southeast Saskatchewan core area.

	2002	2001	2000	1999
Net acres of land [(1)]				
Developed	**6,051**	5,138	1,977	419
Undeveloped	**27,962**	27,145	6,957	2,358
Total	**34,013**	32,283	8,934	2,777
Average Daily Production				
Crude oil & NGLs (Bbl/d)	**887**	639	129	24
Natural gas (Mcf/d)	**47**	56	–	–
Oil equivalent (Boe/d)	**895**	648	129	24
Established Reserves[(2)]				
Crude oil & NGLs (MStb)	**2,746**	2,941	862	36
Natural gas (MMcf)	**839**	906	195	–
Oil equivalent (MBoe)	**2,886**	3,090	895	36
Value of Established Reserves (PV10 $000)[(2)]				
Proven	**23,644**	29,700	10,251	206
Probable (risked @ 50%)	**3,490**	560	1,617	16
Total	**27,134**	30,260	11,868	222

(1) *In addition, Lexxor holds an exclusive option to earn leases by drilling wells involving approximately 36,000 net acres of Talisman Energy Inc. Fee Title Lands.*

(2) *Established reserves are defined as proven reserves plus probable reserves risked at 50%. For 2002, the determination of Lexxor's established reserve value is based on the GLJ Report effective January 1, 2003 using GLJ's April 1, 2003 escalated price forecast.*

Twenty-five per cent of Lexxor's total production during 2002 was from Redvers and Ingoldsby in southeast Saskatchewan. These two properties were acquired in 2001 to augment Lexxor's existing operations for a total of $9 million. The acquisitions included undeveloped lands, existing production of approximately 415 Bbl/d of oil at Redvers, Parkman and Ingoldsby, and proprietary seismic data. In addition, the Talisman acquisition included an exclusive option to earn leases by drilling wells involving 36,000 net acres of Talisman Fee Title Lands on which there is an extensive 3-D seismic database. This option expires March 2004. In addition to generating $12.1 million in revenue during 2001 and 2002, Lexxor's exploratory and development efforts resulted in a combined established reserves value of $14.3 million at Redvers and Ingoldsby.

Southeast Saskatchewan Production

	2002			2001		2000	
(Boe)	**Volume**	**% of Total**	**% change**	Volume	% of Total	Volume	% of Total
Redvers	**113,696**	**35**	**34**	84,556	36	–	–
Ingoldsby	**106,504**	**33**	**138**	44,831	19	9,390	20
Antler	**39,177**	**12**	**(40)**	65,105	28	37,517	79
Viewfield	**11,331**	**3**	**–**	–	–	–	–
Sub-total	**270,708**	**83**	**39**	194,492	83	46,907	99
Other Areas	**55,650**	**17**	**33**	42,028	17	307	1
Total	**326,358**	**100**	**38**	236,520	100	47,214	100

Review of Operations

Redvers

The Redvers property is located due south of the town of Redvers in southeast Saskatchewan. In March 2001, the Corporation completed a $4 million acquisition of properties at Redvers and Edenvale from Talisman Energy Inc. Lexxor operates 13 light Mississippian (Tilston) oil wells tied into a 90% owned and operated central oil processing facility that can process up to 2,000 Bbl/d of oil and 5,000 Bbl/d of produced water.

For the year ended December 31, 2002, the Redvers property produced 113,696 Boe and generated $4.1 million of petroleum and natural gas sales, representing 15% of total sales. It is expected that production at Redvers will decline slightly during 2003. As of December 31, 2002, Lexxor owned a working interest in 1,595 net acres of land at Redvers. Effective January 1, 2003, Lexxor's proved plus probable reserves at Redvers were evaluated at 595 MBoe with a value discounted at 10% before tax of $7.8 million.

Ingoldsby

The Ingoldsby property is located 30 kilometers south of the town of Redvers in southeast Saskatchewan. In November 2001, the Corporation acquired $5 million of producing properties in the Ingoldsby area. Lexxor owns an interest in 4 producing oil wells that are tied into a 50% owned and operated central oil battery. In addition, Lexxor owns a 100% interest in 2 producing oil wells for which produced oil is trucked to the Redvers battery and interests in 12 oil wells producing to other operator's facilities.

For the year ended December 31, 2002, the Ingoldsby property produced 106,504 Boe and generated $3.6 million of petroleum and natural gas sales, representing 13% of total sales. As of December 31, 2002, Lexxor owned a working interest in 1,719 net acres of land at Ingoldsby. Effective January 1, 2003, Lexxor's proved plus probable reserves at Ingoldsby were evaluated at 1,115 MBoe with a value discounted at 10% before tax of $7.5 million.

2003 Activity

During 2003, Lexxor will test a deep Winnipegosis exploratory play in the Viewfield area. The Viewfield property, adding 11,331 Boe of production from the period July 23 to December 31, 2002, was acquired through the Liberty acquisition.

Activities in southeast Saskatchewan during 2003 include development wells in Antler West, Viewfield, Wauchope, and south Ingoldsby.

East Central

The East Central core area was developed primarily through the exploration and development efforts of Lexxor and its partners through the discovery of two Dina oil pools in the Neutral Hills area. During 2002, the acquisition of Liberty added significant production and reserves in the Aerial area in Alberta and the Fosterton area in southwest Saskatchewan.

Review of Operations

	2002	2001	2000	1999
Net acres of land				
Developed	**20,578**	9,116	6,175	3,391
Undeveloped	**33,415**	16,240	8,643	8,008
Total	**53,993**	25,356	14,818	11,399
Average Daily Production				
Crude oil & NGLs (Bbl/d)	**888**	413	64	34
Natural gas (Mcf/d)	**2,085**	1,411	852	869
Oil equivalent (Boe/d)	**1,236**	648	206	179
Established Reserves (1)				
Crude oil and NGLs (MStb)	**2,381**	746	743	378
Natural gas (MMcf)	**7,074**	2,438	3,299	2,415
Oil equivalent (MBoe)	**3,561**	1,152	1,293	780
Value of Established Reserves (PV10 $000) (1)				
Proven	**33,302**	11,255	9,703	3,098
Probable (risked @ 50%)	**3,827**	806	2,757	218
Total	**37,129**	12,061	12,460	3,316

(1) *Established reserves are defined as proven reserves plus probable reserves risked at 50%. For 2002, the determination of Lexxor's established reserve value is based on the GLJ Report effective January 1, 2003 using GLJ's April 1, 2003 escalated price forecast.*

Thirty-eight per cent of the Company's total production was produced at Neutral Hills and Aerial in Alberta and Fosterton in southwest Saskatchewan. The Neutral Hills area was developed through the exploration and development success of the Corporation and represented 27% of total production. The Aerial and Fosterton properties added 93.2 MBoe of production (17% of total) from the period July 23, 2002 to year end as a result of the Liberty acquisition.

East Central Production

	2002			2001		2000	
(Boe)	**Volume**	**% of Total**	**% change**	Volume	% of Total	Volume	% of Total
Neutral Hills	**234,283**	**52**	**67**	139,958	59	14,798	20
Aerial	**74,471**	**17**	**–**	–	–	–	–
Fosterton	**18,715**	**4**	**–**	–	–	–	–
Sub-total	**327,469**	**73**	**134**	139,958	59	14,798	20
Other Areas	**123,782**	**27**	**28**	96,562	41	60,598	80
Total	**451,251**	**100**	**91**	236,520	100	75,396	100

Neutral Hills

Twenty-eight per cent of the Corporation's petroleum and natural gas sales was from the Neutral Hills area, generating $7.9 million during 2002.

The Neutral Hills property is situated in the center of the Provost field of eastern Alberta. The exploration cycle at Neutral Hills was initiated in the fourth quarter of 2000, when Lexxor discovered a new Dina oil pool. In the first quarter of 2002, Lexxor participated in a second oil pool discovery, southeast of Lexxor's original discovery. Since the initial discovery, this area has produced over 389,039 barrels of high quality oil

Review of Operations

(30° API) from a total of 37 wells spread over 5 different Dina pools, generating $13 million of petroleum and gas sales. Lexxor has over 57 square kilometres of trade and proprietary 3-D seismic coverage in the area, which has been instrumental in picking the thickest and structurally highest Dina sand locations. In early 2002, Lexxor and its partner completed the construction of a permanent oil processing facility in the area.

During 2002, this area produced 234.3 MBoe. It is expected that base production will average approximately 390 Boe/d as a result of natural declines during 2003. Lexxor intends to drill two development wells in the area and an exploratory location testing a new Dina anomaly during the second quarter of 2003. As of December 31, 2002, Lexxor owned a working interest in 5,242 net acres of land and can earn an interest in additional lands by electing to drill wells under a new seismic option. Effective January 1, 2003, Lexxor's proved plus probable reserves at Neutral Hills were evaluated at 686 MBoe with a value discounted at 10% of $8.8 million.

Aerial

The Aerial property was acquired through the acquisition of Liberty on July 23, 2002. Producing natural gas, crude oil and NGLs, this property added $2.5 million to the Corporation's petroleum and natural gas sales, representing 9% of total sales for 2002.

This property is located approximately 10 kilometres northeast of the town of Drumheller, Alberta. As of December 31, 2002, Lexxor holds an average 84% working interest in 5,789 net acres of land and an average 87% interest in 31 producing wells. Lexxor owns 42 kilometres of 2-D trade seismic in the area. During 2003, Lexxor expects production at Aerial to generate revenues of approximately $5.4 million from the production of approximately 160 MBoe. Effective January 1, 2003, Lexxor's proved plus probable reserves at Aerial were evaluated at 1,214 MBoe with a value discounted at 10% before tax of $14.6 million.

Fosterton

The Fosterton property was also acquired through the acquisition of Liberty. Producing medium gravity crude oil, this property added $0.6 million to the Corporation's petroleum and natural gas sales, representing 2% of total sales for 2002.

This property is located approximately 56 kilometres west of the town of Swift Current, Saskatchewan. As of December 31, 2002, Lexxor holds a 100% working interest in 5 oil wells producing approximately 175 barrels of oil per day. Plans during 2003 include drilling up to four development oil wells on the property to increase production and optimize oil recovery.

2003 Activity

If development drilling during 2003 in Fosterton is successful, the Corporation intends to review a similar infill development program in the Hazlet area, where Lexxor operates and holds a 49.6% working interest.

Review of Operations

An extensive seismic program conducted in the first quarter of 2003 within the East Central core area is expected to identify additional drilling prospects. Lexxor has been shifting focus towards gas targets in the Gooseberry, Dobson, Veteran, Herronton, and Berry Creek areas and anticipates drilling several of these plays during 2003.

WEST CENTRAL

In the west central core area, Lexxor drilled 6 exploratory wells during 2002 in its efforts to establish a new natural gas reserve and production base. Overall results were disappointing, with year end production increasing to approximately 350 Boe/d compared to year end 2001 production of 85 Boe/d, but lower than the original 800 Boe/d exit rate target. Lexxor is currently evaluating this area's potential for adding significant reserves.

	2002	2001	2000	1999
Net acres of land				
Developed	**4,156**	2,438	1,307	256
Undeveloped	**14,978**	4,345	4,550	3,442
Total	**19,134**	6,783	5,857	3,698
Average Daily Production				
Crude oil & NGLs (Bbl/d)	**50**	13	5	–
Natural gas (Mcf/d)	**1,057**	516	663	26
Oil equivalent (Boe/d)	**226**	99	116	5
Established Reserves (1)				
Crude oil and NGLs (MStb)	**104**	82	49	218
Natural gas (MMcf)	**2,838**	3,196	2,499	788
Oil equivalent (MBoe)	**577**	615	466	349
Value of Established Reserves (PV10 $000) (1)				
Proven	**5,881**	4,344	3,246	1,663
Probable (risked @ 50%)	**513**	31	34	770
Total	**6,394**	4,375	3,280	2,433

(1) *Established reserves are defined as proven reserves plus probable reserves risked at 50%. For 2002, the determination of Lexxor's established reserve value is based on the GLJ Report effective January 1, 2003 using GLJ's April 1, 2003 escalated price forecast.*

West Central Production

	2002			2001		2000	
(Boe)	**Volume**	**% of Total**	**% change**	Volume	% of Total	Volume	% of Total
Whitecourt	**35,964**	**43**	–	–	–	–	–
Other Areas	**47,172**	**57**	**31**	36,135	100	42,456	100
Total	**83,136**	**100**	**130**	36,135	100	42,456	100

Review of Operations

Whitecourt/Carson Creek

The Whitecourt/Carson Creek property is located a few kilometres directly north of the town of Whitecourt in west central Alberta. Lexxor holds an average 55% working interest in 4,544 net acres of land with two natural gas wells currently on production.

For the year ended December 31, 2002, the Whitecourt property produced 35.96 MBoe, averaging 500 Mcf/d of natural gas and 15 Bbl/d of crude oil and NGLs. This property generated $1.2 million of petroleum and natural gas sales, representing 4% of total sales. Lexxor anticipates that during 2003, production in this area will increase significantly to approximately 85 MBoe with existing production augmented by drilling activity. The GLJ Report has assigned reserves of 122 MBoe of proved and probable reserves for this area a value of $2.3 million, discounted at 10% before tax.

2003 Activity

Seismic programs have been completed in April 2003 in the Whitecourt area. These programs will be evaluated to firm up additional Pekisko/Nordegg gas drilling opportunities for later in the year.

Environment and Safety

Exemplary performance in the areas of health, safety, and the environment is essential in fulfilling Lexxor's business goals, enhancing shareholder value, and meeting the needs and expectations of the stakeholders. To achieve this, Lexxor integrates health, safety, and environmental considerations into all decisions affecting the operations of the Company. The policies, systems, and procedures are reviewed periodically for improvements. This is a management responsibility with specific terms of reference to be adhered to as defined by the Board of Directors.

Lexxor personnel and contractors are guided by the following principles:

- Compliance with all environmental laws, legislation, and policies as they relate to environmental matters and employee's health and safety;
- Developing policies, programs, and procedures and review sufficiency of resources available;
- Review environmental compliance issues and ensure timely and effective response and follow-up to incidents resulting from operations. Lexxor's Emergency Response Plan is regularly updated to ensure accuracy of contact information and other essential services;
- Review and monitor health and safety activities as they relate to the employees in the workplace on safety issues;
- Ensuring employees and contractors are properly trained, understand and accept responsibility to operate in a manner consistent with Lexxor safety and environmental policies;
- Remain sensitive to the concerns of the public.

Corporate Guidance and Support

Corporate Governance

The composition of Lexxor's Board of Directors includes five outside directors as defined by The Toronto Stock Exchange guidelines and one inside director. The following individuals serve on the Board of Directors of the Corporation:

C. Barrie Clark — Calgary, Alberta

Douglas O. McNichol — Calgary, Alberta

Larry Nachshen (Chairman) — Beaconsfield, Quebec

John Niedermaier — Calgary, Alberta

Carl Ravinsky — Westmount, Quebec

Ronald J. Will — Calgary, Alberta

The Board of Directors of Lexxor receive periodic reports summarizing Lexxor's exploration, development, acquisition and production activities. In addition, the Board of Directors attended 14 meetings to discuss financial and operating results, potential and realized acquisitions, and other matters relating to the ongoing operations of the Corporation.

In September 2002, the Board of Directors met for the purposes of reviewing and updating the corporate governance practices of the Corporation and to discuss the current and proposed changes to the Instruments and Policies governing the reporting practices of public corporations to its shareholders and the public. Specific Board of Director responsibilities in respect to environment and safety, reserve evaluations, corporate governance, audits, and compensation were reviewed and updated. A formal mandate for the Board, together with a business conduct policy for employees and consultants of the Corporation was formed.

The Board of Directors has an Audit Committee and a Compensation Committee. The Board of Directors as a whole assumes the responsibilities of a Reserves Committee. The Audit Committee meets with the Corporation's auditors, reviews the financial statements and the management's discussion and analysis, and makes recommendations to the Board of Directors for approval. The Compensation Committee reviews targets that are directly linked to any potential bonus payments to the officers of Lexxor, and reviews and approves annual remuneration. In assuming the responsibilities of a Reserves Committee, the Board meets with the reserve engineers and reviews the processes used in evaluating the Corporation's assets.

Corporate Guidance and Support

Our Directors and Officers

Alan R. Bamsey was appointed Vice President, Engineering and Operations in June 2002. Mr. Bamsey has over 25 years of experience in oil and gas operations and is responsible for managing the Company's development and production activities. Mr. Bamsey has a Bachelor of Science degree in Chemical Engineering, is a registered Professional Engineer with APEGGA, and is a member of the Petroleum Society of CIM.

C. Barrie Clark (1) was elected to the Board of Directors in June 2002. Having been actively involved in the oil and gas industry for over thirty years, he is the President of Wilbar Resources Ltd., which provides administrative and financial consulting services to companies in the oil and gas and related industries. Mr. Clark is a Chartered Accountant and a member of the Alberta and Manitoba Institutes of Chartered Accountants. Mr. Clark also serves as a director and non-executive Chairman of Global Link Data Solutions Ltd., a TSXV listed company.

Thomas N. Cotter was appointed Corporate Secretary of Lexxor in March 2001. Mr. Cotter is with the law firm of Heenan Blaikie and has practiced securities and corporate law for 8 years. Mr. Cotter has also taught as a sessional instructor and guest lecturer at the University of Calgary. Mr. Cotter is a lawyer and a member of the Bar of Alberta. Mr. Cotter serves as the secretary of TriQuest Energy Corp. and Bulldog Energy Inc., TSXV listed companies.

B. Cameron Dawes has been the Vice President, Exploration of Lexxor since June 2000. Mr. Dawes has over 27 years of experience in oil and gas exploration and is responsible for managing the Company's exploration and development program. Mr. Dawes holds a Master of Science Degree in Geology, is a registered Professional Geologist with APEGGA, and is a member of the CSPG and AAPG.

J. Paul Lawrence has been the Vice President, Finance of Lexxor since its inception in September 1995. Twenty-four of Mr. Lawrence's 30 years of experience in financial accounting has been in the oil and gas industry. Mr. Lawrence is a Chartered Accountant and a member of the Canadian, Alberta and Ontario Institutes of Chartered Accountants and is a member of Financial Executives International.

Douglas O. McNichol (2) has been the President and a director of Lexxor since February 1999. Mr. McNichol has over 23 years of broad and diversified experience in all aspects of the oil and gas industry. Mr. McNichol holds a Bachelor of Science degree in Mechanical Engineering and is a registered Professional Engineer with APEGGA.

Larry Nachshen (3) was elected to the Board of Directors in April 2000 and became Chairman of the Board in June 2002. Mr. Nachshen is the President of the Petrovest Group of Companies and has 15 years of experience in the energy and resource sectors. Mr. Nachshen also serves as Chairman of the Board of Directors of Fairstar Exploration Inc., a TSX listed mining exploration company. Mr. Nachshen resides in Beaconsfield, Quebec.

Corporate Guidance and Support

John A. Niedermaier (1) (2) has been a director of Lexxor since February 1999. With over 40 years of experience in oil servicing, Mr. Niedermaier is the President of Mi Casa Rentals Inc., a company specializing in oil and gas wellsite rentals. Mr. Niedermaier holds a Bachelor of Science degree in Agricultural Engineering (Bioscience) is a registered Professional Engineer with APEGGA, and is a member of CADE, CIMM, CAODC(1986), and OTS. Mr. Niedermaier also serves as a director of Purcell Energy Ltd. and Drillers Technology Corp., both TSX listed companies, and Technicoil Corporation, a TSXV listed company.

Dwight T. Ostrosser was appointed Vice President, Land of Lexxor in August 2000. Mr. Ostrosser has over 20 years of experience in the oil and gas industry and is responsible for managing Lexxor's Land Department. Mr. Ostrosser is a Professional Landman and is a member of the Canadian Association of Professional Landmen and the American Association of Professional Landmen.

Carl M. Ravinsky was elected to the Board of Directors in April 2000. Mr. Ravinsky is a lawyer whose areas of practice are securities and taxation. Mr. Ravinsky is a member of the Bar of Quebec, the Bar of Alberta, and the Bar of Ontario. Mr. Ravinsky has over 15 years of extensive experience in the financings of junior resources issuers. Mr. Ravinsky is also a Director of Fairstar Exploration Inc., a TSX listed mining exploration company. Mr. Ravinsky resides in Montreal, Quebec.

Ronald J. Will (1) (2) has been a director of Lexxor since its inception in September 1995. Mr. Will has a Bachelor of Science degree and over 30 years of broad and diversified experience as a financial advisor, including over 20 years with Richardson Greenshields Ltd. Mr. Will is currently a financial advisor at Jennings Capital Inc. and is also a director and Chairman of the Board of Purcell Energy Ltd., a TSX listed company, and Grey Island Systems Ltd., a TSVX listed technology company.

(1) Member of the Audit Committee
(2) Member of the Compensation Committee
(3) Chairman of the Board

Management's Discussion and Analysis of Financial Condition

Management's Discussion and Analysis focuses on information contained in the Financial Statements and the related notes. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur which could affect the Company in the future. In order to obtain the best overall perspective, this discussion should be read in conjunction with the material contained in other parts of this annual report.

Lexxor, building on the successful exploitation carried out in 2001, combined with its acquisition of Liberty Oil & Gas Ltd. ("Liberty") in July of 2002, extended its record of growth and profitability commenced in 1999. During 2002, Lexxor initiated its efforts to establish a third core area in west central Alberta spending $4.1 million to drill 6 gross wells (4.55 net wells). While initial results are somewhat disappointing with production from the area at year end at approximately 2,000 Mcf/d (versus 442 Mcf/d in 2001), Lexxor has established several promising prospects in this area and intends to continue with its exploration and development efforts during 2003.

In 2003, Lexxor will continue its strategies for growth that include the acquisition of oil and gas properties complementary to our core areas and an active exploration and development program. Our emphasis in 2003 will be to work towards a more balance product mix, to re-establish Lexxor's financial position, and to build on our history of growth.

Liberty Acquisition

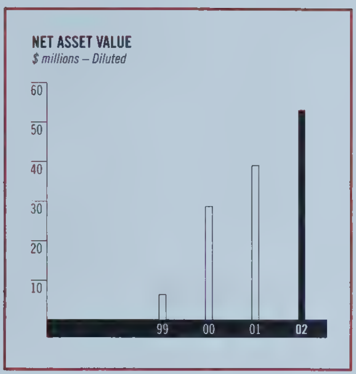
The acquisition of Liberty by means of a Plan of Arrangement ("Arrangement") on July 23, 2002 added approximately 1,000 Boe/d of production, 2.9 million Boe of established reserves (at a cost of approximately $8.26 per established Boe), and an inventory of 22,563 net acres of undeveloped land and seismic valued at approximately $1.3 million at December 31, 2002. Lexxor has solid prospect leads on some of these lands and there are a number of drilling opportunities that have been planned for 2003. Additionally, Lexxor has identified areas where operating costs can be lowered. These initiatives will be undertaken in 2003 and will add additional value to this acquisition.

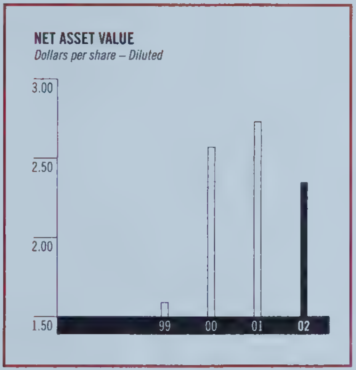
The acquisition resulted in Lexxor issuing 990,551 Lexxor Common shares and 990,551 Lexxor Warrants to Liberty shareholders. In addition, Lexxor agreed to assume Liberty's debt of approximately $13.6 million and contribute 1.3 million Lexxor common shares and $6.8 million in satisfaction of Liberty's creditor claims. Acquiring Liberty increased Lexxor's overall production by 50% to more than 3,000 Boe/d (August 2002), provided Lexxor further exposure to natural gas, increasing production in July from 2,000 Mcf/d to approximately 4,250 Mcf/d and provided some upside drilling potential. In order to reduce the combined debt resulting from the Arrangement, Lexxor undertook a number of financings of Common and Common flow-through shares and intends to dedicate a portion of cash flow generated in 2003 to debt reduction.

Net Asset Value

In November 2002, Lexxor consolidated its reserve evaluation under one independent engineering firm. Previously, Liberty's independent engineers were Gilbert Laustsen Jung Associates Ltd. ("GLJ'). The consolidation of Lexxor's reserve evaluation under GLJ resulted in a downward adjustment of 892.8 MBoe to Lexxor's established reserve base as at January 1, 2003.

Management's Discussion and Analysis of Financial Condition





Lexxor's net asset value per share, based on established reserves decreased by 14% to $2.35 per share diluted as at December 31, 2002 from $2.74 per share diluted as at December 31, 2001. This decrease resulted from improved commodity prices (GLJ price forecast April 1, 2003) offset by an 18% downward revision to prior years' reserves, lower than expected reserve additions from Lexxor's 2002 exploratory drilling program, a higher level of debt, and a 58% increase in the number of diluted shares outstanding. Lexxor's diluted value includes the exercise of 1,914,000 options (exercisable at an average exercise price of $1.70). Not included in the number of diluted shares are 1,387,900 outstanding warrants exercisable at $2.50 and 990,551 warrants exercisable at $3.00 per share.

Net Asset Value

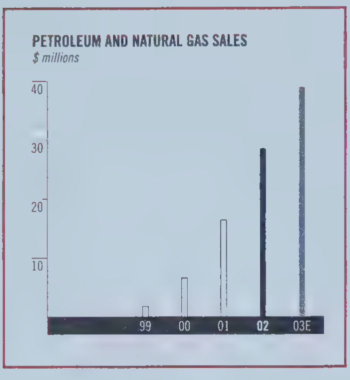
For the years ended December 31 (000's)	**2002**	2001	2000
Oil and gas reserves [1]			
Proven reserves	**63,524**	45,857	24,306
Risked probable reserves	**7,904**	1,402	4,605
Gross overriding royalties [2]	**401**	359	451
	71,829	47,618	29,362
Land, Seismic and Other:			
Undeveloped land	**4,919**	3,809	1,392
Seismic and other	**3,296**	2,534	600
Working capital deficit and long term debt ($M)	**(30,081)**	(16,216)	(4,638)
Net asset value-basic ($M)	**49,963**	37,745	26,716
Exercise of convertible securities ($M)	**3,245**	1,611	2,004
Net asset value-diluted ($M)	**53,208**	39,356	28,720
Basic shares outstanding (000)	**20,706**	13,400	9,874
Exercise of convertible securities ($M)	**1,914**	959	1,306
Diluted shares outstanding (000)	**22,620**	14,359	11,180
Net asset value per share-basic	**$2.41**	$2.82	$2.71
Net asset value per share-diluted	**$2.35**	$2.74	$2.57

(1) *Proven and risked probable reserves (50% risk) discounted at 10% before tax.*
(2) *Gross overriding royalties include royalty acquired with Icon Energy Limited and miscellaneous royalties in southeast Saskatchewan acquired from Talisman. Values estimated internally by management.*
(3) *Assumes 1,914,000 stock options (in the money) outstanding as at December 31, 2002 are exercised at an average price of $1.70 per share.*
(4) *Warrants outstanding to purchase 1,387,900 Common shares exercisable at $2.50 and 990,551 Common shares at $3.00 have not been included in the diluted calculation.*

PRODUCTION (SALES) *(gas converted to a barrel of oil equivalent at a conversion rate of 6:1)*

Production for 2002 increased on a barrel of oil equivalent basis 69% to average 2,357 Boe/d versus 1,395 Boe/d in 2001. This increase is mainly attributed to exploitation and development activities that occurred throughout 2001 being on production for the entire year in 2002 and to the Liberty acquisition in July 2002. Lexxor's production mix averaged 3,189 Mcf/d of natural gas (23% of total production) up from 1,983 Mcf/d of natural gas in 2001 and 1,825 Bbls/d of oil and NGLs, (77% of total production) up from 1,065 Bbls/d in 2001.

Management's Discussion and Analysis of Financial Condition



Lexxor's production mix is projected to change slightly in 2003 with oil and NGLs contributing 64% of total production and natural gas contributing 36% of total production. Total production for the year is expected to average 3,400 Boe/d, an increase of 44% from 2,357 Boe/d in 2002. Production from existing properties is expected to average 2,730 Boe/d while discoveries and extensions are expected to add approximately 670 Boe/d to Lexxor's 2003 average from capital expenditures of $12.6 million.

Lexxor experienced disappointing results in its efforts to establish a third core area in west central Alberta (west of 5th meridian). Exit 2002 production from this area was expected to be 800 Boe/d, compared to actual year end production of approximately 350 Boe/d. The Company is currently reviewing its exploration and exploitation strategy in this area for 2003.

Lexxor's drilling program successfully replaced its production declines, however was unsuccessful in its efforts to add production, meeting 2002 annual targets only as a result of the acquisition of Liberty. Total production for 2002 was expected to average 2,500 Boe/d. Actual production for the year was 2,357 Boe/d. Lexxor's exit rate was in line with our original expectations at approximately 3,000 Boe/d.

Production (Sales) by Area

	2002			2001		2000	
(Boe)	**Volume**	**% of Total**	**% change**	Volume	% of Total	Volume	% of Total
Neutral Hills	**234,283**	**27**	**67%**	139,958	27	14,798	8
Redvers	**113,696**	**13**	**34%**	84,556	17	–	–
Ingoldsby	**106,504**	**12**	**138%**	44,831	9	9,390	5
Aerial	**74,471**	**9**	**–**	–	–	–	–
Antler	**39,177**	**5**	**-40%**	65,105	13	37,517	21
Whitecourt	**35,964**	**4**	**–**	–	–	–	–
Fosterton	**18,715**	**2**	**–**	–	–	–	–
Viewfield	**11,331**	**1**	**–**	–	–	–	–
Other Properties	**226,001**	**27**	**29%**	174,882	34	118,557	66
Total	**860,142**	**100**	**69%**	509,332	100	180,262	100

Average Prices

The average price received per barrel of oil equivalent in 2002 remained relatively constant during the year, increasing 5% from $32.24 per Boe to $33.94 per Boe. The natural gas price decreased 14% from $5.30 per Mcf in 2001 to $4.54 in 2002 while the oil and NGLs price fluctuated to average $35.89 per Bbl up 11% from $32.37 per Bbl in 2001. Natural gas prices at AECO ranged from a low of $3.00 per Mcf in February 2002 to a high of $5.66 per Mcf in November 2002 while West Texas Intermediate ("WTI") traded in a range from US$19.73 per barrel in January to US$29.38 per barrel in December 2002.

Management's Discussion and Analysis of Financial Condition

Lexxor has a commodity price risk strategy that is intended to protect Lexxor's cash flow against significant downward risk to product prices by providing price protection on a portion of its future production. This strategy offers Lexxor some exposure to upside price movements. During 2002, management implemented its strategy on product pricing to lock in prices on a portion of Lexxor's oil and natural gas production. This strategy resulted in an overall hedging loss of $0.84 per Boe comprised of a gain on natural gas hedging of $0.14 per Mcf offset by a loss on oil hedging of $1.34 per Bbl.

Lexxor has prepared its 2003 Budget using an average WTI oil price of US$25.00 and a Cdn/US exchange rate of $1.54. The adjustment for quality differential and transportation produces an average oil and NGLs price of $33.59 per Bbl. As a result of recent international events, the price of WTI has averaged well over US$30.00 per Bbl to date in 2003. Lexxor has several costless collars covering 1,350 Bbls/d of oil. Lexxor has costless collars in place for 350 Bbls/d with a floor of US$25.00 and a ceiling of US$29.80 and 1,000 Bbls/d with a floor of US$23.10 and a ceiling of US$25.42, all expiring on April 30, 2003.

Lexxor's budget price for natural gas for 2003 averages $4.55 per Mcf. Lexxor has two contracts to deliver natural gas totaling 2,500 GJ/d. The first contract for 1,000 GJ/d of natural gas has an AECO price of $5.07 per GJ until May 1, 2003 after which time the price drops to $5.03 per GJ until its expiry October 31, 2003. The second contract for 1,500 GJ/d has an AECO price of $5.15 per GJ until May 1, 2003 after which time the price drops to $5.03 per GJ until its expiry October 31, 2003. Current gas prices are above Lexxor's current projected yearly average enabling Lexxor to build a cushion early in the year to offset for gas price declines that usually occur after the winter heating season has ended.

Lexxor is confident that its current budget projections for both oil and natural gas despite recent prices are well within the limits of sound financial prudence and the Company has not, as yet, adjusted its outlook. It is expected that if current high commodity prices continue, Lexxor will dedicate a portion of the increased cash flow primarily to repaying bank indebtedness.

Commodity Prices

$	**2002**	% change	2001	2000
Oil and NGLs (barrels)	**666,167**	**71%**	388,692	77,116
Natural Gas production (Mcf)	**1,163,854**	**61%**	723,840	618,876
Barrels of oil equivalent (Boe) 6:1	**860,142**	**69%**	509,332	180,262
WTI oil price - $US/barrel	**$26.08**	**1%**	$25.90	$30.20
Average exchange rate	**1.57**	**1%**	1.55	1.49
WTI oil price - $Cdn	**$40.95**	**2%**	$40.09	$44.87
Quality differential and transportation	**$5.06**	**-34%**	$7.72	$3.10
Lexxor oil price ($Cdn/barrel)	**$35.89**	**11%**	$32.37	$41.77
Lexxor gas price ($Cdn/Mcf)	**$4.54**	**-14%**	$5.30	$5.58

Management's Discussion and Analysis of Financial Condition

Netbacks

Barrel of Oil Equivalent Cash Netback

The average cash netback price (after general and administrative, interest and capital tax expenses) received during 2002 was $14.40 per Boe, a 3% increase from $13.94 per Boe realized in 2001. This $0.46 increase in the Boe cash netback results from a relatively constant price (up 5% or $1.70 per Boe), higher hedging costs (up 600% or $0.84 per Boe), lower ARTC (down 22% or $0.16 per Boe as a lower percentage of overall production emanated from Alberta), higher interest costs (up 36% or $0.32 per Boe as the Company's average debt level increased during the year) and capital tax of $0.25 per Boe versus none in 2001. These increased costs are offset by lower general and administrative expenses (down 10% or $0.32 per Boe) as a result of a higher production base. Total royalties at $7.60 per Boe (down 3% from $7.87 per Boe in 2001) or 22% of oil and gas revenues (25% in 2001) and operating costs at $7.29 per Boe (up 5% from $6.91 per Boe in 2001) remained relatively constant year over year.

The average cash netback price for 2003 estimated at $14.19 per Boe is expected to remain similar to that realized in 2002 - $14.40 per Boe. The average price per Boe is budgeted to decrease 8% to $31.32 (5% after hedging loss of 2002) reflecting a slightly lower average oil price. Royalties are expected to remain at the same percentage as in 2002 and operating costs on a Boe basis are estimated to remain consistent with that realized in 2002. The expected benefit of the ARTC in 2003 of $0.29 per Boe is lower than that realized in 2002 ($0.56 per Boe) as a higher percentage of Lexxor's production comes from Saskatchewan. Due to the expected higher production averages estimated for 2003, both general and administrative and interest expense per Boe are expected to be lower in 2003 than in 2002.

Operating Cash Netback

BOE	2002	% change	2001	2000
Sales - total	**860,142**	**69%**	509,332	180,262
- per day	**2,357**	**69%**	1,395	494
Revenue	**$33.94**	**5%**	$32.24	$37.01
Hedging	**($0.84)**	**600%**	($0.12)	($0.22)
Royalties	**(7.60)**	**-3%**	(7.87)	(7.04)
ARTC	**0.56**	**-22%**	0.72	0.39
Operating	**(7.29)**	**5%**	(6.91)	(7.53)
Operating netback	**$18.77**	**4%**	$18.06	$22.61
General and administrative	**(2.91)**	**-10%**	(3.23)	(4.62)
Interest	**(1.21)**	**36%**	(0.89)	(1.16)
Capital Tax	**(0.25)**	**–**	–	–
Cash Netback	**$14.40**	**3%**	$13.94	$16.83

Management's Discussion and Analysis of Financial Condition

Commodity Netbacks

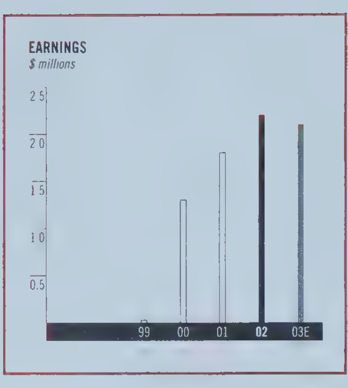
Oil and NGLs (Bbls)		2002	% change	2001	2000
Sales	- total	**666,167**	**71%**	388,692	77,116
	- per day	**1,825**	**71%**	1,065	211
Revenue		**$35.89**	**11%**	$32.37	$41.77
Hedging		**($1.34)**	**100%**	–	–
Royalties		**(8.09)**	**15%**	(7.05)	(6.68)
ARTC		**0.63**	**21%**	0.52	0.07
Operating cost		**(8.14)**	**47%**	(5.54)	(7.87)
Operating Netback		**$18.95**	**-7%**	$20.30	$27.29

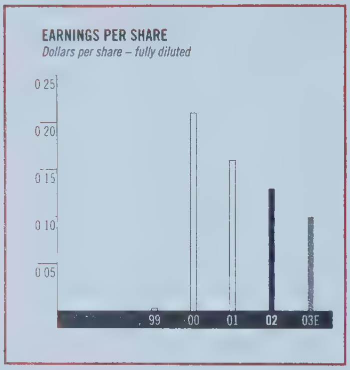
Natural Gas (Mcf)		2002	% change	2001	2000
Sales	- total	**1,163,854**	**61%**	723,840	618,876
	- per day	**3,189**	**61%**	1,983	1,696
Revenue		**$4.54**	**-14%**	$5.30	$5.58
Hedging		**$0.14**	**-275%**	($0.08)	($0.06)
Royalties		**(0.99)**	**-43%**	(1.75)	(1.22)
ARTC		**0.06**	**-74%**	0.23	0.10
Operating cost		**(0.73)**	**-61%**	(1.89)	(1.21)
Operating Netback		**$3.02**	**67%**	$1.81	$3.19

The operating netback for oil and NGLs remained relatively constant decreasing 7% or $1.35 per Bbl. The $3.52 per Bbl higher average price received in 2002 was offset by a hedging loss of $1.34 per Bbl and an increase in operating costs of $2.60 per Bbl. Operating costs increased due to unseasonably wet weather experienced in southeast Saskatchewan in early summer, a number of workovers required to maintain or improve production on Liberty properties acquired, and higher field costs for trucking of new production, chemicals and fuel. Royalties for oil and NGLs, that are determined based on production from each well, increased in proportion to the higher price received in 2002 but remained constant at approximately 22% of revenue. ARTC decreased as a result of lower proportionate production from Alberta.

The lower average price budgeted in 2003 for oil (US$25.00 WTI in 2003 versus US$26.08 in 2002) is within the costless collars in place and the gas forward price is expected to be within Lexxor's contract price in the summer producing an average similar to that realized in 2002. The average prices assumed in Lexxor's 2003 budget eliminate the hedging gains and losses realized in 2002. If oil prices were to remain at their current level for the greater part of the year, Lexxor could realize significant gains. Each increase of US$1.00 in WTI produces approximately $850,000 of additional cash flow to Lexxor. While the Company's current oil hedging position (1,350 Bbls/d at an average of US$26.56 until April 30, 2003) will negate some of this current pricing upside, it is possible that prices will remain high allowing Lexxor to capitalize on the current strong oil prices.

Management's Discussion and Analysis of Financial Condition





The operating netback per Mcf for natural gas increased 67% in 2002 to $3.02 per Mcf over $1.81 per Mcf realized in 2001. This increase is primarily related to lower gas royalty rates that decreased from 34% of natural gas revenue in 2001 to 21% in 2002 and lower operating costs. This decrease in royalty rates is attributed to the application of a higher gas cost allowance and lower rate wells attracting a lower percentage royalty. The decrease in operating costs is attributed to a higher production base of lower cost wells acquired in the Liberty transaction.

Management expects the natural gas operating netback to decrease 27% in 2003 to $2.19 per Mcf primarily as a result of higher royalties and operating costs of new production. Management has determined its focus in 2003 is on increasing gas production. This is expected to result in higher royalty rate wells than those currently producing and slightly higher operating costs as Lexxor ventures into new areas where it does not own facilities.

EARNINGS

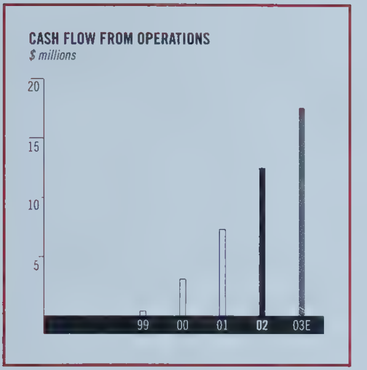
Lexxor's average production increase of 69% during the year produced an increase in petroleum and natural gas sales of 74% to $28.5 million from $16.4 million in 2001. The increase in production increased expenses, generally in proportion to the production increases, resulting in an earnings increase of 20% to $2.2 million in 2002 from $1.8 million the prior year. Earnings were negatively affected by higher depletion, depreciation and site restoration expenses (up 105%), higher interest expense (up 132%) and capital tax.

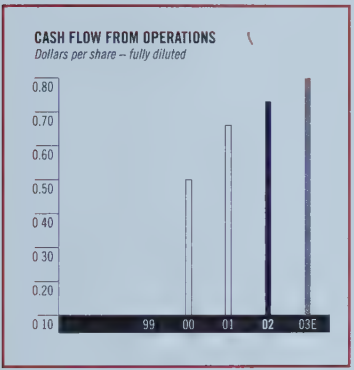
On a per share basis, basic earnings per share declined 24% (19% diluted) to $0.13 per share basic ($0.13 per share diluted) in 2002 from $0.17 ($0.16 per share diluted) in 2001. This decrease is primarily the result of depletion, depreciation, and site restoration expense increasing 105% on a basic (and diluted) per share basis and interest expense increasing 36% on a basic (50% diluted) per share basis. As a result of share offerings and the Liberty acquisition, Lexxor had more shares outstanding in 2002 than in 2001 with a weighted average of 16,423,184 basic and 17,009,168 diluted versus 10,857,075 basic and 11,063,904 diluted in 2001.

Management is disappointed that earnings have not kept pace with other operational gains and increases. The decrease in per share earnings is directly attributable to a negative reserve adjustment Lexxor experienced at year end, to the higher finding and development costs experienced in 2002 and to Lexxor being subject to capital tax commencing in 2002.

Earnings in 2003 are expected to decrease slightly to $2.1 million ($0.10 per share basic) from $2.2 million ($0.13 per share basic) in 2002, due primarily to higher depletion and depreciation expense. Lexxor management is focused on rectifying the ongoing impact of the reserve adjustment in 2002 and the impact of higher finding and development costs experienced in 2002 on future earnings. Lexxor intends to allocate $4.9 million of its capital budget to exploratory activities in 2003, expending the remainder of funds raised in 2002 through the sale of flow-through shares. Management has conducted a thorough review of its prospect inventory and has identified 34 possible exploratory locations. It is expected that commencing in 2003, a rigorous focus on economics and risk assessment will add additional reserves at lower finding costs and re-establish the trend of reducing the depletion and depreciation rate.

Management's Discussion and Analysis of Financial Condition





Earnings Netback

BOE	2002	% change	2001	2000
Cash Netback	14.40	3%	13.94	16.83
Depletion, depreciation, and site restoration	(9.83)	22%	(8.08)	(5.96)
Provision for taxes	(2.38)	-8%	(2.59)	(3.44)
Earnings netback	2.20	-33%	3.27	7.43

Cash Flow from Operations

Cash flow from operations increased 70% in 2002 to $12.5 million ($0.76 per share basic and $0.73 per share diluted) from $7.3 million ($0.68 per share basic and $0.66 per share diluted) in 2001. The increase is attributable to higher average production and slightly higher prices and netbacks.

Cash flow in 2003 is expected to increase 38% to approximately $17.6 million ($0.85 per share basic). This projection is based on an average production rate of 3,400 Boe/d of which 2,730 will come from current producing reserves, an operating netback of $17.25, (8% less than that realized in 2002), lower general and administrative expense, and slightly higher interest, and capital tax expense compared to 2002. Our 2003 budget produces a cash netback of $14.19 per Boe versus $14.40 realized in 2002.

The increased cash flow from operations and the proceeds from the sale of non-core properties (estimated at $1 million) will support a capital expenditure budget of approximately $13.6 million and permit the reduction of Lexxor's bank indebtedness by approximately $5 million, re-establishing a more conservative fiscal policy.

		Petroleum and Natural Gas Sales $M	Cash Flow from Operations $M	Basic Per Share $	Diluted Per Share $	Earnings (Loss) $M	Basic Per Share $	Diluted Per Share $
2000	Q1	523	32	0.00	0.00	(36)	0.00	0.00
	Q2	990	331	0.05	0.05	140	0.02	0.02
	Q3	1,659	692	0.11	0.11	406	0.06	0.06
	Q4	3,460	2,055	0.26	0.26	830	0.11	0.10
	Total	6,632	3,110	0.50	0.50	1,340	0.22	0.21
2001	Q1	3,643	1,708	0.15	0.15	578	0.05	0.05
	Q2	3,517	1,559	0.15	0.15	384	0.05	0.05
	Q3	4,753	2,026	0.19	0.19	579	0.05	0.05
	Q4	4,449	2,052	0.17	0.17	266	0.02	0.02
	Total	16,362	7,345	0.68	0.66	1,807	0.17	0.16
2002	**Q1**	**4,899**	**2,090**	**0.15**	**0.15**	**390**	**0.03**	**0.03**
	Q2	**6,108**	**2,360**	**0.16**	**0.16**	**463**	**0.03**	**0.03**
	Q3	**8,170**	**3,824**	**0.20**	**0.20**	**910**	**0.05**	**0.05**
	Q4	**9,288**	**4,181**	**0.21**	**0.20**	**411**	**0.02**	**0.02**
	Total	**28,465**	**12,455**	**0.76**	**0.73**	**2,174**	**0.13**	**0.13**
Budget 2003		38,851	17,609	0.85		2,059	0.10	

Per share numbers do not necessarily add due to weighting of shares.

Management's Discussion and Analysis of Financial Condition

Sensitivity Analysis [1]

	Forecast	Change of	Cash Flow	Per Share	Earnings	Per Share
Crude oil and NGLs:	2,176 Bbl/d	100 Bbl/d	$762,000	$0.03	$239,000	$0.01
	$25 US/Bbl	$1 US/Bbl	$849,000	$0.04	$546,000	$0.02
Natural gas:	7,344 Mcf/d	1,000 Mcf/d	$746,000	$0.03	$460,000	$0.00
	$4.55/Mcf	$0.25/Mcf	$489,000	$0.02	$319.000	$0.01
Currency	$0.65 US	$0.01 US	$381,000	$0.02	$251,000	$0.01

(1) *Sensitivity analysis is based on $25.00 WTI oil per Bbl and $4.55 per Mcf for natural gas.*

With oil and NGLs representing 64% of 2003 budgeted production, Lexxor's cash flow and earnings are most sensitive to a $1.00 US/Bbl change in the price of WTI. A $1.00 US/Bbl change in the price of WTI oil generates a $849,000 change in cash flow ($0.04 per share diluted) and a change of $546,000 in earnings ($0.02 per share diluted).

The ability of Lexxor to meet its 2003 budget projections is dependent on exploration and development drilling success, reasonable stability in commodity prices, interest rates and currency rates, and the ability to manage our indebtedness.

Lexxor manages these risks through its use of extensive seismic, commodity hedges when appropriate, by maintaining sound financial parameters, and by relying on our experienced staff for sound financial and economic direction.

Fourth Quarter 2002

The fourth quarter of 2002 reflects a full quarter of the combined operations of Liberty and Lexxor and more accurately portrays the ongoing results expected. Combined production averaged 2,900 Boe/d versus 2,002 Boe/d in Q4 2001. Revenues increased 109% to total $9.3 million versus $4.4 million in Q4 2001 due to a higher production base and much-improved prices. On a Boe basis, Q4 2002 received an average sales price of $36.75 per Boe up 52% from $24.16 per Boe in Q4 2001. The oil and NGLs price averaged $37.02 per Bbl in Q4 2002 versus $25.23 per Bbl in Q4 2001 while natural gas prices averaged $6.03 per Mcf in Q4 2002 versus $3.08 per Mcf in Q4 2001. Operating netbacks in Q4 2002 were significantly improved over Q4 2001. Our Q4 2002 Boe netback was $19.28 (Q4 2001 $13.65 per Boe) made up of an oil and NGLs netback of $16.53 per Bbl (Q4 2001 $15.64 per Bbl) and a natural gas netback of $4.18 per Mcf (Q4 2001 $0.52 per Mcf). Cash flow from operations for the fourth quarter of 2002 totaled $4.2 million, double the $2.1 million for the fourth quarter of 2001.

Revenue

Petroleum and natural gas sales totaled $28.5 million up 74% from $16.4 million in 2001. Sales from oil and NGLs increased 83% from $12.6 million in 2001 to $23.0 million in 2002 and represented 81% of total petroleum and natural gas sales. Natural gas sales increased 44% from $3.8 million to $5.5 million and represented 19% of total petroleum and natural gas sales. Lexxor contributed total sales of $23.4 million while Liberty from July 23, 2002 to year end contributed $5.1 million of total sales.

Management's Discussion and Analysis of Financial Condition

Petroleum and Natural Gas Revenue by Area

	2002			2001		2000	
	$M	% of Total	% change	$M	% of Total	$M	% of Total
Neutral Hills	**7,935**	**28**	**78%**	4,459	27	560	8
Redvers	**4,149**	**15**	**62%**	2,568	16	–	–
Ingoldsby	**3,648**	**13**	**155%**	1,400	9	389	6
Aerial	**2,520**	**9**	**–**	–	–	–	–
Antler	**1,403**	**5**	**-41%**	2,385	15	1,717	26
Whitecourt	**1,220**	**4**	**–**	–	–	–	–
Fosterton	**613**	**2**	**–**	–	–	–	–
Viewfield	**448**	**2**	**–**	–	–	–	–
Minor Properties	**6,529**	**23**	**19%**	5,550	34	3,966	60
Total	**28,465**	**100**	**74%**	16,362	100	6,632	100

Royalties

Total royalties paid on production, including the Saskatchewan resource surcharge, during 2002 increased 63% to $6.5 million and represented a royalty rate of 23% versus 25% in 2001. During 2002, Lexxor paid $4.7 million ($2.7 million in 2001) in Crown royalties and $1.8 million ($1.3 million in 2001) in freehold and overrides. The royalty on petroleum and NGLs during 2002 totaled 23% ($5.4 million) versus 22% in 2001 and on natural gas totaled 21% ($1.1 million) versus 34% in 2001. The natural gas royalty percentage rate decreased due to the application of higher capital cost allowance in 2002 and lower producing wells attracting a lower royalty rate.

Alberta Royalty Tax Credit (ARTC)

The ARTC provides a royalty credit against a maximum of $2.0 million of royalties payable to the Crown based on a price sensitive formula of between 25% and 75%. The royalty rate in 2001 and 2002 was at the program's minimum of 25%. In 2002, the ARTC reduced total Alberta royalties paid by $0.5 million versus a reduction of $0.4 million in 2001. This program is essential to small and medium sized producers in an environment of low prices and provides some stabilization of cash flow during the periods of low commodity prices. Lexxor is continually directing a higher proportion of its drilling program to Alberta projects. As a result the ARTC will become a more important factor in the determination of Lexxor's royalty rates.

Operating Expenses

Operating expenses increased 78% (corresponding with the 74% increase in production) to $6.3 million in 2002 from $3.5 million in 2001. Oil and NGLs operating expenses totaled $5.4 million or $8.14 per Boe while natural gas operating expenses totaled $0.9 million or $0.73 per Mcf.

Management's Discussion and Analysis of Financial Condition

General and Administrative Expenditures

Gross general and administrative expenditures totaled $4.6 million in 2002, a 17% increase from $4.0 million in 2001. Increased expenditures were incurred due to the higher number of employees and full time consultants required to handle the higher average level of production and operator responsibilities resulting from the Liberty acquisition, a one time severance payment paid to a former officer and higher expenses for office space, legal fees, engineering evaluation fees and other corporate expenses.

Lexxor currently has 24 employees and utilizes consultants as required. It is expected, that even as production increases or property acquisitions are completed, the number of employees and consultants required will not increase significantly in 2003. Management expect that as production increases, Lexxor's cost per Boe will continue to be reduced and will continue to be comparable with industry peers.

Lexxor capitalizes those expenditures related to land, geological and geophysical activities and the overhead related to those activities. In 2002, Lexxor capitalized $1.3 million of general and administrative expenditures versus $1.6 million in 2001. Overhead recovery, generated from Lexxor being operator of capital projects and operating wells, reduced total expenditures by $0.8 million in both 2002 and 2001.

Net general and administrative expense (after capitalized overhead and overhead recovery) totaled $2.5 million, up from $1.6 million in 2001. On a Boe basis, Lexxor incurred $5.39 per Boe in 2002 compared to $7.80 per Boe in 2001 of gross general and administrative expenditures and $2.91 per Boe in 2002 compared to $3.23 per Boe in 2001 on a net basis, after capitalized overhead and overhead recoveries. These numbers have decreased due to the higher production base.

$000	**2002**	Change	2001	2000
Production (Sales)				
– total (Boe)	**860,142**	69%	509,332	180,262
– per day (Boe/d)	**2,357**	69%	1,395	494
Gross Expenditures	**4,634**	17%	3,974	1,407
Overhead recoveries	**(829)**	9%	(761)	(204)
Capitalized overhead	**(1,306)**	-17%	(1,566)	(370)
Net Expense	**2,499**	52%	1,647	833
Gross expenditures per Boe ($)	**5.39**	-31%	7.80	7.81
Net expense per Boe ($)	**2.91**	-10%	3.23	4.62

Interest Expense

Interest expense increased to $1.0 million in 2002 up from $0.5 million in 2002, due in part to the bank debt assumed and the cash provided to settle creditor claims required in the Liberty acquisition and to capital expenditures incurred in excess of cash flow generated resulting in a higher average level of indebtedness in 2002 versus 2001. Interest rates during 2002 were slightly lower than in 2001 with the prime rate of interest ranging from a low of 3.75% in January to a high of 4.5% in July. Lexxor's interest rate varies from prime to prime plus 1% depending on our debt to cash flow ratio for the preceding quarter.

Management's Discussion and Analysis of Financial Condition

Based on Q4 2002 debt to cash flow, the interest rate for Q1 2003 will be adjusted downward to prime plus one-eighth.

Depreciation, Depletion and Site Restoration

Depreciation, depletion and site restoration expense increased in 2002 to $8.5 million up 63% from $4.1 million in 2001. On a Boe basis, depreciation, depletion and site restoration increased from $8.08 per Boe in 2001 to $9.83 in 2002. Lexxor's depreciation, depletion and site restoration rate per Boe has increased due to our downward reserve adjustment and the higher finding and development costs experienced in 2002.

At December 31, 2002, a liability for future removal and site restoration costs of $1.4 million (including $0.6 related to Liberty) has been recognized in the financial statements. Total estimated costs for future removal and site restoration were $3.9 million, up from $1.6 million in 2001. Of this increase, $1.9 million is related to the acquisition of Liberty.

Future Income Taxes

Lexxor recorded a provision for income taxes of $2.0 million in 2002 versus $1.3 million in 2001. The 2002 provision includes $216,680 of capital tax expensed in the current year.

During the year, Lexxor agreed to issue $8.3 million of flow-through Common shares and incur $8.3 million in qualifying expenditures prior to December 31, 2003. At December 31, 2002, the Company had incurred $3.4 million of qualifying expenditures and must incur the remaining $4.9 million during 2003. By flowing these expenditures through to investors, the tax deductions are unavailable to the Company.

At December 31, 2002, Lexxor had exploration and development costs, undepreciated capital costs, unamortized share issue costs and non-capital losses available for deduction against future taxable income of approximately $54.3 million. Although not currently taxable, Lexxor needs to maintain a reasonable capital budget and avoid the reliance on the issuance of flow-through shares to access capital.

Recent proposals tabled in the Federal Budget of February 18, 2003 will affect oil and gas companies. The federal capital tax will be eliminated by 2008. The rate reduces from 22.5% in 2003 to 6.25% in 2007 and the capital deduction used in the calculation of the base increases to $50.0 million in 2004 from $10.0 million currently. The federal statutory income tax rate on income earned from resource activities will reduce from 28% to 21% commencing with a reduction of 1% in 2003 reaching 21% in 2007. This means that the combined federal and Alberta corporate income tax rate will reduce over the next five years from 42.12% in 2002 to 35.12% in 2007. Over a period of five years, the resource allowance deduction available to compensate for the non-deductibility of Crown royalties will be phased out and the deductibility of these Crown royalties will be phased in. In addition, the ARTC, now a non-taxable form of government assistance will become taxable over a five year transitional period.

These changes are expected to be beneficial to Lexxor as currently our resource allowance deduction is less than the deduction that will be allowed for Crown royalties net of the ARTC.

Management's Discussion and Analysis of Financial Condition

Additions to Capital Assets

$000	2002	Change	2001	2000
Land	**1,260**	-7%	1,349	94
Geological and seismic	**1,146**	-1%	1,148	163
Drilling and completions	**11,128**	32%	8,388	3,010
Well equipment and tie-ins	**3,742**	-24%	4,592	1,843
Direct general and administrative	**1,232**	-21%	1,566	370
Office furniture, equipment and other	**44**	-66%	133	34
	18,552	6%	17,176	5,514
Purchase of property	**24,168**	172%	9,352	8,464
Total capital additions	**42,720**	65%	26,528	13,978
Sale of Property	**(2,047)**	27%	(1,628)	(454)
Net capital additions	**40,673**	67%	24,900	13,524

Capital additions during 2002, including the addition of Liberty, totaled $42.7 million. The acquisition of Liberty added $23.8 million, $18.6 million was spent on seismic, land, drilling, facilities and capitalized general and administrative expenditures of which $17.9 was spent on Lexxor properties and $0.7 million was spent on Liberty properties. $0.3 million was spent on minor property acquisitions. During the year, a further $2.6 million was spend in the Neutral Hills area on drilling, completions and facilities, $1.9 at Whitecourt on drilling and completions, $1.5 million at Antler on drilling and completions and $1.3 million at Pembina on drilling and completions. Capitalized general and administrative expenditures relating to acquisition, exploration and development activities during 2002 totaled $1.2 million versus $1.6 million in 2001.

During the year, Lexxor disposed of a total of $2.0 million of non-core property of which $1.4 was Lexxor property and $0.6 was Liberty property. Lexxor sold property at Wauchope, Wood River, Westerose and other minor properties while Liberty sold property at Pembina and Basset.

During 2002, Lexxor participated in the drilling of 42 (27.8 net) wells versus 43 (26.6 net) wells in 2001. Drilling in 2002 produced disappointing results adding 929,500 Boe of proven reserves (1,035,600 Boe of established reserves) at a cost of $19.96 per proven Boe ($17.91 per established Boe). The acquisition of Liberty added proven reserves at $10.17 per Boe ($8.26 per established Boe).

Financial Resources and Liquidity

Lexxor satisfies its capital requirements through the generation of cash flow, the utilization of debt and from the issue of equity. In addition to these conventional capital sources and to generate additional funds for operating, the Company will occasionally dispose of properties that have either been fully exploited or do not continue to meet the Company's operational and financial criteria. The Board of Directors has mandated that the debt to current cash flow ratio should be between 1:1 and 2:1. Lexxor's debt to cash flow ratio at year end was 2.41:1 based on trailing cash flow and 1.79:1 based on Q4 cash flow annualized. The ratio is at the higher end of the range as a result of the decision to acquire Liberty in 2002 and efforts will be made

Management's Discussion and Analysis of Financial Condition

in 2003 to reduce this ratio to a lower level. Lexxor's decision to incur additional debt in the Liberty transaction of approximately $20.4 million was based on the then low cost of financing, a very affordable and attractive asset package, an immediate increase in production of approximately 1,000 Boe/d and with the commitment to reduce debt to lower levels through equity offerings and the dedication of cash flow to repayment of a portion of this indebtedness. In anticipation of the Liberty transaction, the Company entered into three private placements raising $3.8 million and in May and July committed to flow-through share offerings totaling $2.8 million. After the closing of the Liberty transaction, Lexxor committed to raise an additional $5.5 million in flow-through share financings. In addition, approximately $5.0 million of 2003 cash flow has been allocated for debt reduction during the year. At present, the oil and gas commodity market is producing prices that are stronger than the average assumed in Company's 2003 budget. Should these strong prices continue, the excess cash flow over budget could allow a slightly higher capital budget and additional debt reduction.

The Company intends to maintain a reasonable capital expenditure budget in 2003 to not only ensure that the commitments under flow-through share offerings completed in 2002 are met but also to continue to grow the Company's production and reserve base.

During the year the Company issued 5.0 million shares for gross proceeds of $11.1 million. Of this, 3.0 million shares were issued on a flow-through basis for gross proceeds of $7.3 million and 93,000 were issued on the exercise of stock options for proceeds of $114,200. In addition Lexxor committed to issue an additional 425,532 flow-through shares for gross proceeds of $1.0 million. Lexxor also issued 2.9 million shares pursuant to the Arrangement with Liberty at $1.945 per share.

As part of the private placement of Common shares in May 2002, the Company issued 1.4 million warrants expiring November 2, 2003. One warrant plus $2.50 is required to purchase one Common share of Lexxor. As part of the Arrangement to purchase Liberty, the Company issued 990,551 warrants expiring July 23, 2004 to shareholders of Liberty. One warrant plus $3.00 is required to purchase one Common share of Lexxor.

At December 31, 2002, Lexxor had issued or committed to issue 20.7 million Common shares. On December 19, 2002, Lexxor announced that the TSX had accepted a notice filed by Lexxor to renew its normal course issuer bid. During 2002, under the terms of this and the previous Normal Course Issuer Bid (expiry December 19, 2002) the Company purchased a total of 483,900 Common shares of which 89,268 were allocated to the employee stock savings plan and 394,632 were cancelled. These Common shares were purchased at an average cost of $1.93 per Common share plus commission. The Company may, during the 12-month period commencing December 20, 2002 and ending December 19, 2003 purchase on the TSX up to 1.0 million Common shares. A portion of the shares purchased will be used by the Company pursuant to its employee stock savings plan and the remainder will be cancelled. In January and February 2003 the Company has purchased 81,700 Common shares at an average cost of $1.81 per Common share of which 17,743 were allocated to the employee stock savings plan and 63,957 are to be cancelled. Lexxor intends to remain active in purchasing its shares under its normal course issuer bid purchasing, at a minimum, the

Management's Discussion and Analysis of Financial Condition

shares required to fulfill the obligations under the employee savings plan (approximately 8,000 shares per month). If the opportunity presents itself for Lexxor to purchase its shares at less than its underlying value, Lexxor will dedicate additional funds to this purchase.

At December 31, 2002 Lexxor had total debt and working capital deficiency of $30.1 million. Management has included in this debt and working capital deficiency number an amount that it believes is recoverable from the Monitor under the terms of the Liberty Plan of Arrangement. The finalization of the Liberty purchase price has not occurred. Management believes that by issuing the Common Shares and providing cash and an irrevocable Letter of Guarantee totaling $6,811,425 to the Monitor, Lexxor substantially fulfilled its obligations with respect to the Arrangement. Subsequent to closing, management is disputing the proposed distribution of cash received by Liberty during the CCAA period.

The Company's credit facilities with a Canadian chartered bank consist of a revolving operating demand loan of $33.0 million (Facility A) and a non-revolving acquisition/development demand loan of $4.0 million (Facility B). Drawings under Facility A totaled $28.7 million at year end. No drawings were outstanding under Facility B at year end. Lexxor anticipates that its drawings under Facility A peaked in January of 2003 at slightly less than $30.0 million. Management in its 2003 budget has provided that throughout the remainder of the year, repayments from cash flow and minor property sales will gradually reduce indebtedness to approximately $25.0 million at year end. Based on projected cash flow of $17.6 million in 2003, Lexxor's debt to cash flow is expected to be reduced to 1.4 : 1 by year end.

At January 1, 2003, Lexxor's proven producing reserve base as determined by GLJ using the GLJ April 1, 2003 price forecast is $51.5 million (PV10%). Preliminary discussions with Lexxor's banker indicate that our lending base cannot support a $33.3 million line of credit for the entire year and reductions of the Facility may be necessary. The results of Lexxor's capital expenditure program and reserves added in 2003 will determine what reductions of the Facility or repayments of debt will be required.

Lexxor Common shares commenced trading on the TSX on July 26, 2002. In 2002, Lexxor traded 4.2 million shares on the TSX Venture Exchange and the TSX. The high for 2002 was $2.40 (May), the low for the year was $1.45 (February) and the closing price at December 31, 2002 was $1.70.

Lexxor currently has 20.7 million shares issued and outstanding, 1.4 million warrants outstanding exercisable at $2.50 that expire November 2, 2003, 990,551 warrants outstanding exercisable at $3.00 that expire July 23, 2004 and 2.0 million options to purchase Common shares outstanding at an average exercise price of $1.73.

On January 13, 2003, Lexxor announced a process to review strategic alternatives for maximizing shareholder value. Lexxor's board is of the opinion that despite solid growth posted over the past four years, Lexxor's share price trades at prices that do not reflect the underlying value of its asset base. This process is expected to take until approximately the end of April. Lexxor's board has no assurance that another acceptable alternative will be determined. As a result, Lexxor is continuing its full cycle of exploration and development and has undertaken a rationalization process examining its current product mix, its activity

Management's Discussion and Analysis of Financial Condition

levels, its areas of operation and its prospect inventory. If another alternative is not accepted, Lexxor's board and management are of the opinion that Lexxor's increasing annual production will provide constantly improved operational and financial results leading eventually to new and improved parameters allowing stakeholders to benefit from the market's recognition of Lexxor's value.

Summary of Trading During 2002

	Price Range ($)			Volume
Period	High	Low	Close	(000's)
First Quarter	2.20	1.45	2.20	866
Second Quarter	2.40	1.80	2.05	1,146
Third Quarter	2.30	1.70	2.25	736
Fourth Quarter	2.30	1.68	1.70	1,488
				4,236

On July 26, 2002, Lexxor's common shares commenced trading on the Toronto Stock Exchange ("TSX") under the symbol LXX.

Market Capitalization

Common shares issued or to be issued as at December 31, 2002	20,705,674
Closing market price as at December 31, 2002	$1.70
Market value of common shares ($000's)	35,200
Bank indebtedness and working capital deficiency ($000's)	30,081
Provision for future removal and site restoration ($000's)	1,399
Future income taxes ($000's)	7,201
Market capitalization as at December 31, 2002 ($000's)	73,881

Lexxor's market capitalization at December 31, 2002 is calculated using the year end closing price of $1.70 per share.

Management's Report

To the Shareholders of Lexxor Energy Inc.

The financial statements of Lexxor Energy Inc. and other financial information included in this annual report have been prepared by management. It is management's responsibility to ensure that sound judgment, appropriate accounting principles and methods, and reasonable estimates have been used in the preparation of this information. They also ensure that all information presented is consistent with that reported in the financial statements.

Management is also responsible for developing internal controls over the financial reporting process. Management believes the system of internal controls, the review procedures and the established policies provide timely information and reasonable assurance as to the reliability and relevance of financial reports to management. Management also believes that Lexxor's operations are conducted in conformity with the law and with a high standard of business conduct.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Committee, which consists of non-management directors, reviews the financial statements and annual report, and recommends them to the Board for approval. The Committee meets with management and external auditors to discuss internal controls, auditing matters and financial reporting issues. External auditors have full and unrestricted access to the Audit Committee. The Committee also recommends a firm of external auditors to be appointed by the Shareholders.

Douglas O. McNichol
President & Chief Executive Officer

J. Paul Lawrence
Vice President, Finance &
Chief Financial Officer

February 7, 2003

Calgary, Alberta

Auditors' Report

To the Shareholders of Lexxor Energy Inc.

We have audited the consolidated balance sheet of Lexxor Energy Inc. as at December 31, 2002 and the consolidated statements of earnings and deficit and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2001 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated February 28, 2002.

BDO Dunwoody LLP

Chartered Accountants

Calgary, Alberta

February 7, 2003

Consolidated Financial Statements

Consolidated Balance Sheets

As at December 31	2002	2001
Assets		
Current		
Cash and cash held in trust (Note 8(b)(i))	**$ 1,046,667**	$ 60,636
Accounts receivable	**7,994,927**	5,498,790
Prepaid expenses and other assets	**695,757**	235,729
Promissory notes receivable (Note 4(a))	–	366,633
Loan receivable (Note 4(b))	–	2,750,000
	9,737,351	8,911,788
Capital assets (Note 5)	**70,133,733**	37,563,822
	$ 79,871,084	$ 46,475,610
Liabilities and Shareholders' Equity		
Current		
Accounts payable and accrued liabilities	**$ 11,069,453**	$ 8,527,593
Bank indebtedness (Note 6)	**28,748,595**	13,850,000
Long term equipment loan (Note 4(b))	–	2,750,000
	39,818,048	25,127,593
Future income taxes (Note 9)	**7,201,000**	3,577,000
Future removal and site restoration (Note 7)	**1,398,988**	449,988
	48,418,036	29,154,581
Commitments and contingencies (Note 10)		
Shareholders' equity		
Share capital (Note 8)	**31,567,680**	19,332,598
Share purchase loans (Note 8(g))	**(62,900)**	–
Deficit	**(51,732)**	(2,011,569)
	31,453,048	17,321,029
	$ 79,871,084	$ 46,475,610

The accompanying notes are an integral part of these consolidated financial statements

Approved on behalf of the Board:

Signed *"Douglas O. McNichol"* Director
Douglas O. McNichol

Signed *"C. Barrie Clark"* Director
C. Barrie Clark

Consolidated Financial Statements

Consolidated Statements of Earnings and Deficit

For the years ended December 31	2002	2001
Revenue		
Petroleum and natural gas sales	$ 28,465,188	$ 16,362,245
Royalties	(6,536,942)	(4,008,964)
Alberta Royalty Tax Credit	485,741	366,218
	22,413,987	12,719,499
Interest and other income	68,972	140,943
	22,482,959	12,860,442
Expenses		
Operating	6,271,029	3,520,089
General and administrative	2,498,961	1,646,743
Interest	1,041,176	451,010
Depletion, depreciation and site restoration	8,452,100	4,115,000
	18,263,266	9,732,842
Earnings before taxes	4,219,693	3,127,600
Provision for corporate taxes (Note 9)	2,045,680	1,320,550
Earnings for the year	2,174,013	1,807,050
Deficit, beginning of year	(2,011,569)	(3,818,619)
Common shares repurchased and cancelled (Note 8(e))	(214,176)	–
Deficit, end of year	$ (51,732)	$ (2,011,569)
Earnings (loss) per share		
Basic	$ 0.13	$ 0.17
Diluted	0.13	0.16
Weighted average number of shares		
Basic	16,423,184	10,857,075
Diluted	17,009,168	11,063,904

The accompanying notes are an integral part of these consolidated financial statements

Consolidated Financial Statements

Consolidated Statements of Cash Flows

For the years ended December 31	2002	2001
Cash flows from operating activities		
Earnings for the year	$ 2,174,013	$ 1,807,050
Items not effecting cash		
Provision for future income taxes	1,829,000	1,320,550
Depletion, depreciation and site restoration	8,452,100	4,115,000
General and administrative	–	102,225
Cash flow from operations	12,455,113	7,344,825
Change in non-cash working capital	261,479	(1,257,721)
	12,716,592	6,087,104
Cash flows from financing activities		
Increase in bank indebtedness	1,302,554	10,750,000
Issue of common shares	12,079,411	6,188,819
Repurchase of common shares (Note 8(e))	(789,777)	–
Share and warrant issue costs	(969,249)	(380,389)
	11,622,939	16,558,430
Cash flows from investing activities		
Expenditures on capital assets	(18,905,336)	(26,359,513)
Proceeds from sale of properties	2,047,013	564,277
Acquisition of Liberty (Note 3)	(7,863,139)	–
Change in non-cash working capital	1,367,962	2,288,371
	(23,353,500)	(23,506,865)
Increase (decrease) in cash	986,031	(861,331)
Cash and cash held in trust, beginning of year	60,636	921,967
Cash and cash held in trust, end of year	$ 1,046,667	$ 60,636
Cash flow from operations per share		
Basic	$ 0.76	$ 0.68
Diluted	$ 0.73	$ 0.66

The accompanying notes are an integral part of these consolidated financial statements

Notes to Consolidated Financial Statements

December 31, 2002 and 2001

1. Description of Business

The Company's business is the acquisition of and the exploration for and development and production of crude oil and natural gas in Canada. The Company's shares are listed for trading on the Toronto Stock Exchange ("TSX"). Lexxor Energy Inc. (the "Company" or "Lexxor") was incorporated under the laws of the Province of Alberta on August 8, 1995.

During the year ended December 31, 2001, the Company reorganized its share capital whereby the issued and issuable Class A voting shares were exchanged for newly created Common voting shares at a ratio of five (5) Class A shares for one (1) Common share. The number of Common shares, Common share options and warrants outstanding, Common share prices and per share calculations for the prior period had been restated to reflect this reorganization.

2. Significant Accounting Policies

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of consolidated financial statements involves the use of estimates and approximations, which have been made using careful judgment. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

The financial statements for the year ended December 31, 2002 have been consolidated to include the accounts of the Company and its wholly owned subsidiaries, 999546 Alberta Ltd., and Liberty Oil & Gas Ltd. ("Liberty" - see Note 3) and Liberty's wholly owned subsidiary 3860337 Canada Ltd. On January 1, 2003, Liberty and the Company were amalgamated, continuing under the name of Lexxor Energy Inc.

(a) Petroleum and natural gas properties

(i) Cost

The Company follows the full cost method of accounting for petroleum and natural gas properties, whereby all costs related to the acquisition of, exploration for and development of petroleum and natural gas properties and related reserves are capitalized. Such costs include land acquisition costs, geological and geophysical expenditures, and costs of drilling both productive and non-productive wells, tangible production equipment and that portion of general and administrative expenditures directly related to acquisition, exploration and development activities.

Capitalized costs, including tangible production equipment, are depleted and depreciated using the unit-of-production method based on estimated proven reserves of petroleum and natural gas before royalties as determined by an independent petroleum engineering firm, converting natural gas to an oil equivalent basis using six thousand cubic feet of natural gas for one barrel of petroleum.

Notes to Consolidated Financial Statements

(ii) Future removal and site restoration costs

Estimated future costs of site restorations, including the removal of production facilities at the end of their useful lives, are provided for on a unit of production basis. The estimate is based on currently known information, existing legislation and technology. Changes in these factors may result in material changes to estimated costs, which will be recognized prospectively when known. The annual provision is included in depletion, depreciation and site restoration expense. Actual expenditures incurred are applied against the accumulated liability.

(iii) Depreciation

Office furniture and equipment is depreciated on a straight-line basis per annum over their estimated useful life of ten years. Computer equipment is depreciated on a straight-line basis per annum over their estimated useful life of three years.

(iv) Impairment

The Company applies a ceiling test to net capitalized costs to ensure that such costs do not exceed the estimated undiscounted future net revenues from proven reserves before royalties. The calculation of the ceiling test considers prices and costs in effect at year-end, plus the value attributed to undeveloped properties (net of any impairment), less amounts associated with future general and administrative, site restoration, financing and income tax expenses. Where the estimated net recoverable amount is less than the net carrying amount of capitalized costs, then a write-down to the estimated net recoverable amount is recorded, with a charge to earnings.

(v) Disposals

Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets. However, when a disposal would change the depletion and depreciation rates by more than 20%, a gain or loss on disposal would be recorded.

(vi) Joint activities

Substantially all of the Company's exploration and production activities are conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

(b) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Under the liability method of accounting for income taxes, the future income taxes related to the temporary difference arising at the later of renunciation and when the qualifying expenditures are incurred, are recorded at that time together with a corresponding reduction to the carrying value of the shares issued.

Notes to Consolidated Financial Statements

(c) Financial instruments

The Company carries various financial instruments. It is management's opinion that the Company is not exposed to significant currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

(d) Income taxes

The Company uses the liability method of accounting for income taxes. Under this method, future income tax liabilities and future income tax assets are recorded based on temporary differences - the difference between the carrying amount of an asset and liability in the balance sheet and its tax basis. Future income tax assets and liabilities are measured using income tax rates expected to apply in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in earnings in the period that the change is substantively enacted. Future income tax assets are evaluated and if realization is not considered "more likely than not", a valuation allowance is provided.

(e) Executive and Employee Share Options

The Company has established two stock option plans whereby the Company may grant options to purchase Common shares to its directors, officers, employees and consultants. Under the new stock option plan, options are granted at the closing market price of the Common shares on the date immediately preceding the date of grant, vest over a two year period or as determined by the board of directors of the Company and expire no later than five years from the date of grant. All future options are to be granted under the new stock option plan. The options outstanding under the prior plan are exercisable over a five-year period and expire on January 15, 2004.

Effective January 1, 2002, the Company adopted the recommendations of CICA Handbook Section 3870, Stock Based Compensation and Other Stock Based Payments. This section requires that direct awards of stock and liabilities based on the price of Common shares be measured at the fair value at each reporting date, with the change in fair value reported in the consolidated statement of earnings and encourages, but does not require, the use of the fair value method for all other types of stock-based compensation plans.

During the year, the Company amended its stock option plan effective January 1, 2002, such that neither of the Company's stock option plans qualify as direct awards of stock or as plans that create liabilities based on the price of the Company's stock and as a result, the implementation of this section has no impact on the financial statements. The new stock option plan had a surrender option in consideration for the benefit realized. The amendment to the plan was made to remove this option. Under the new recommendations, the Company is required to disclose the pro-forma net earnings and earnings per share using the fair market value method of accounting for stock based compensation awards granted after January 1, 2002 [see note 8(f)]. Pro-forma disclosure is not required for awards granted prior to January 1, 2002.

The Company records no compensation expense when options are issued to employees. Any consideration paid by employees on the exercise of the options is credited to Share capital.

Notes to Consolidated Financial Statements

(f) Inventory

Inventory is valued at the lower of cost or net realizable value. Cost is determined as the cost to produce the inventory.

(g) Earnings per Share

Basic earnings and cash flow from operations per share were calculated on the basis of the weighted average number of shares outstanding for the year.

The Company uses the treasury stock method of computation, presentation and disclosure of diluted per share amounts under which only "in the money" dilutive stock options and other instruments impact the diluted calculations. Proceeds obtained upon exercise of "in the money" options would be used to repurchase Common shares at the average market price during the year. The diluted weighted average number of Common shares is then calculated based on these assumed transactions.

(h) Employee Share Savings Plan

During the year, the Company initiated an employee share savings plan whereby each employee may elect to contribute up to 5% of their regular salary with the Company matching the contribution with the funds used to purchase shares of the Company. The Common shares are purchased through the facilities of the TSX. Included in general and administrative expense is $83,502 of expenditures related to this plan.

3. Acquisition of Liberty

On July 23, 2002, Lexxor and Liberty implemented the Plan of Arrangement ("the Arrangement") involving Lexxor, Liberty, its shareholders, its subsidiary, 3860337 Canada Ltd., its unsecured creditors, and Lexxor Acquisition Company Ltd. (Lexxor's wholly owned subsidiary). Upon the completion of the acquisition Lexxor Energy Inc. and Liberty were amalgamated continuing under the name of Lexxor.

Under the terms of the Arrangement, Lexxor acquired all the issued and outstanding common shares of Liberty based on one Lexxor Common share plus one Lexxor Warrant (exercisable at $3.00 until July 23, 2004) for every 17.6818 Common shares of Liberty resulting in the issuance of 990,551 Lexxor Common Shares and 990,551 Lexxor Warrants. No value was assigned to the Warrants at the time of the Arrangement.

The Arrangement also provided for Lexxor to assume Liberty's debt to its lender totaling $13,596,041; as well, Lexxor provided $6,811,425 cash and 1,316,195 Lexxor Common shares to allow Liberty to settle creditors' claims.

The acquisition of Liberty at July 23, 2002 has been accounted for using the purchase method and the operations of Liberty have been included in the financial statements from this date forward. The preliminary estimate (note 10(c)) of the purchase price allocation to the assets acquired and liabilities assumed based on their fair values is set out in the following table:

Notes to Consolidated Financial Statements

	Book Value	Fair Value
Net working capital	$ 1,677,113	$ 1,677,113
Capital assets	26,206,153	23,814,688
Future tax asset	–	1,054,000
Companies' Creditor Arrangement Act ("CCAA") payables	(11,453,079)	(9,371,424)
Bank indebtedness	(13,596,041)	(13,596,041)
Future removal and site restoration liability	(576,835)	(600,000)
Net assets acquired	$ 2,257,311	$ 2,978,336

The purchase price of $2,978,336 is comprised of the value attributed to the shares issued of $1,926,622 plus transaction costs of $1,051,714.

The purchase price includes an amount that management believes is recoverable from the Monitor under the terms of the Arrangement. In the event that the Company settles this balance at an amount different from this accrual, the difference will be treated as a purchase price adjustment (Note 10(c)). The resulting difference will be an adjustment between working capital and the value attributed to the capital assets acquired.

The Arrangement required that Liberty's creditors agree to settle a portion of their outstanding claims against Liberty through the receipt of Lexxor Common shares valued at $1.945 per Common share and cash totaling $6,811,425 ('the creditor pool"). Lexxor subsequently paid into the creditor pool, a cash payment of $905,135, issued a Letter of Guarantee of $5,906,290 and issued 1,316,195 Common shares. As at December 31, 2002, the Letter of Guarantee has been reduced by $3,580,937 to settle creditor claims.

The 990,551 Common shares issued to the Liberty shareholders and 1,316,195 Common shares issued to settle with the Liberty's creditors for $4,486,621 has been excluded from the consolidated statement of cash flows as these were non-cash transactions.

4. Related Party Transactions

Except as noted elsewhere in these consolidated financial statements, the Company was involved in the following related party transactions:

(a) Promissory Notes Receivable

In March 2001, Lexxor sold certain oil and gas properties for $333,333 to a company controlled by Lexxor's former Chairman and CEO ("Related Party"). The Company accepted as partial payment a promissory note, bearing interest at prime plus 1% per annum, totaling $233,333, which is included in Promissory Notes Receivable of $366,633 at December 31, 2001. On March 13, 2002 the Related Party sold the oil and gas properties to an unrelated third party. The Promissory Note Receivable was transferred to the third party. Interest received on the promissory note from the Related Party in 2002 was $2,209 (2001 - $12,814).

Notes to Consolidated Financial Statements

Lexxor had also guaranteed to the Related Party the annual cash flow on the properties sold from November 1, 2000 to November 1, 2002, excluding capital costs (the "Annual Guarantee") to be not less than $80,000 per year. Where the annual cash flow exceeds the Annual Guarantee, the excess was to be equally apportioned to the Company and the Related Party. The Annual Guarantee was continued under the same terms with the unrelated party. No payment was made to the Related Party in 2002 (2001 - $10,000).

(b) Sale of Facilities

Effective December 14, 2001, the Company sold certain gathering equipment and batteries ("the Facilities") for proceeds of $2,750,000 to the Lexxor Equipment Financing Limited Partnership ("the Partnership"). The Partnership was a related party to the Company because three directors of the Company owned approximately 37% of the limited partner units in the Partnership. In 2001, this sale-leaseback transaction was accounted for as a financing transaction.

The General Partner of the Partnership was unable to obtain satisfactory debt financing for the Partnership with the result that Lexxor and the Partnership agreed that the Company would acquire the Facilities effective March 31, 2002 for a purchase price of $2,700,000. Accordingly, the consideration originally received of $2,750,000 consisting of a current loan receivable of $2,500,000 and a long term Promissory note receivable of $250,000 due from the Partnership as well as a long term equipment loan due to the Partnership of $2,750,000 have been discharged.

All related party transactions in the normal course of operations have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties.

5. Capital Assets

	2002	2001
Petroleum and natural gas properties	**$ 73,470,670**	$ 41,045,232
Production equipment	**20,398,110**	12,194,583
	93,868,780	53,239,815
Accumulated depletion	**(23,965,450)**	(15,877,150)
	69,903,330	37,362,665
Office furniture and equipment	**350,203**	306,157
Accumulated depreciation	**(119,800)**	(105,000)
	230,403	201,157
	$ 70,133,733	$ 37,563,822

Undeveloped properties with a carrying cost of $4,100,000 at December 31, 2002 (2001 - $2,500,000) have been excluded from costs subject to depletion and depreciation.

During the year ended December 31, 2002, the Company capitalized $1,231,979 (2001 - $1,565,894) of general and administrative expenditures related to acquisition, exploration and development activities.

Notes to Consolidated Financial Statements

6. Bank Indebtedness

		2002		2001
Facility A:				
Revolving Operating Demand Loan at prime rate				
plus 0.25% averaging 4.60% (2001 - 6.50%)	$	**8,748,595**	$	2,750,000
Bankers Acceptance at variable rates				
averaging 4.11% (2001 - 4.24%)		**20,000,000**		8,000,000
Facility B:				
Non-revolving Acquisition/Development Demand Loan at prime rate				
plus 0.50% averaging 4.80% (2001 - 7.00%)		–		3,100,000
	$	**28,748,595**	$	13,850,000

Effective January 1, 2002, the Company retroactively adopted the recommendations of CICA pronouncement EIC-122, whereby the demand loans have been reclassified, presented and disclosed as bank indebtedness in current liabilities.

In August 2002, the Company agreed to a revised credit facility consisting of a $33,000,000 Revolving Operating Demand Loan (Facility A), and a $4,000,000 Non-Revolving Acquisition/Development Demand Loan (Facility B).

Facility A bears interest at rates from prime to prime plus 1.00%. The rate payable is calculated based on the Debt to Cash flow Ratio for the preceding fiscal quarter. As at December 31, 2002, the current rate established for Facility A is prime plus 1/4%. Facility A includes drawings relating to cheques outstanding of $1,900,000 at December 31, 2002 (2001 - $2,500,000). This facility is allowed to revolve and fluctuate at the Company's discretion without fixed repayment terms and is subject to an annual review.

Facility B bears interest at prime plus 0.50%.

The above indebtedness is secured by a $50,000,000 Supplemental Debenture covering all assets of the Company. A corporate guarantee from Liberty for $25,000,000 has also been provided. Cash interest paid approximates interest expense.

7. Future Removal and Site Restoration

At December 31, 2002, the total estimated costs relating to future site restoration and well abandonment are estimated to be $3,879,000 (2001 - $1,630,000) of which $1,398,988 (2001 - $449,988) has been recorded in the consolidated financial statements as a liability.

Notes to Consolidated Financial Statements

8. Share Capital

(a) Authorized

Unlimited number of Common voting shares
Unlimited number of Class B voting shares

(b) Issued and Issuable

	December 31, 2002		December 31, 2001	
Common shares	**Number**	**Amount**	Number	Amount
Balance, beginning of year	**13,400,093**	**$ 19,332,598**	9,873,750	$ 14,009,393
Issued pursuant to flow-through share offerings (Note 8(b)(ii))	**3,007,035**	**7,250,206**	2,689,350	–
Issued on exercise of stock options by employees, officers, and directors	**93,000**	**114,200**	165,500	5,306,560
Issued on Liberty acquisition to creditors (Note 3)	**1,316,195**	**2,559,999**	–	145,150
Issued on Liberty acquisition to shareholders (Note 3)	**990,551**	**1,926,622**	–	–
Issued for cash pursuant to private placement	**1,867,900**	**3,777,905**	–	–
Repurchased and cancelled (Note 8(e))	**(394,632)**	**(575,601)**	–	–
Issued on exercise of warrants	–	–	671,493	1,007,334
Issue costs net of future income taxes of $415,000 (2001 - $160,000)	–	**(554,249)**	–	(220,389)
Tax benefits renounced on flow-through shares	–	**(3,264,000)**	–	(915,450)
Balance issued and outstanding	**20,280,142**	**30,567,680**	13,400,093	19,332,598
To be issued ((Note 8(b)(i))	**425,532**	**1,000,000**	–	–
Net balance, end of year	**20,705,674**	**$ 31,567,680**	13,400,093	$ 19,332,598

(i) In June 2002, the Company entered into an agreement with MRF 2002 Limited Partnership to issue 425,532 Common shares under a private placement of flow-through shares at $2.35 per flow-through Common share for gross proceeds of $1,000,000. The funds were held in trust for the Company pending the Company issuing the forms prescribed in the Income Tax Act (Canada), incurring the qualified expenditures of $1,000,000 and issuing the shares. In December 2002, the Company incurred all of the qualifying expenditures and in February 2003 filed the required forms and documents, issued the 425,532 Common shares and received $1,000,000 from the funds held in trust. The Company incurred an agent fee of $60,000 related to this financing.

(ii) The following is a continuity of flow-through Common shares issued and outstanding:

	Number of Shares	Amount
December 31, 2002		
May	873,800	$ 2,053,430
July	296,500	696,775
October	1,836,735	4,500,001
Balance issued	3,007,035	7,250,206
To be issued	425,532	1,000,000
	3,432,567	$ 8,250,206

Notes to Consolidated Financial Statements

	Number of Shares		Amount
December 31, 2001			
May	250,000	$	500,000
July	657,183		1,478,660
October	266,667		600,000
December	1,515,500		2,727,900
Balance issued	2,689,350		5,306,560
To be issued	–		–
	2,689,350	$	5,306,560

In 2003, the Company is required to incur $4,876,000 of qualified expenditures relating to the issuance of flow-through Common shares. During the year, certain officers and employees of the Company purchased 15,200 flow-through Common shares for $32,060.

(c) Warrants

As part of the Arrangement to purchase Liberty on July 23, 2002, the Company issued 990,551 warrants to Liberty shareholders (Note 3).

As part of the private placement of flow-through Common shares in May 2002, the Company issued 1,387,900 warrants expiring November 2, 2003. One warrant plus $2.50 is required to purchase one Common share.

On June 30, 2002, 4,037,092 warrants issued on the acquisition of DMB Energy Inc. expired unexercised.

(d) Executive and Employee Common Share Options

The following is a continuity of stock options outstanding for which shares have been reserved:

	2002		2001	
	Shares (000s)	**Weighted Average Exercise Price**	Shares (000s)	Weighted Average Exercise Price
Outstanding, beginning of year	**959**	**$ 1.68**	559	$ 1.58
Granted	**1,146**	**1.87**	661	1.94
Exercised	**(93)**	**(1.23)**	(169)	(0.88)
Cancelled	**(21)**	**(1.60)**	(92)	(4.41)
Outstanding, end of year	**1,991**	**$ 1.73**	959	$ 1.68

Notes to Consolidated Financial Statements

The following table is an analysis of outstanding and exercisable stock options as at December 31, 2002:

	Outstanding Options		Exerciseable Options
Exercise Price ($)	December 31, 2002 Number (000s)	Weighted Average Remaining Contractual Life (years)	December 31, 2002 Number (000s)
0.75	30	0.47	30
0.90	91	0.73	91
1.25	80	1.04	80
1.32	7	3.92	4
1.40	34	1.55	16
1.50	671	2.32	168
1.70	30	0.60	30
1.75	88	0.81	53
1.80	30	0.58	30
1.85	40	4.58	–
1.95	55	0.76	27
2.00	570	4.53	–
2.05	74	2.80	–
2.10	11	8.42	–
2.15	3	4.31	–
2.20	100	2.73	–
2.50	77	0.35	–
	1,991		529

On June 19, 2002 at the Company's Annual Meeting, the shareholders approved a maximum of 1,660,000 Common shares be reserved for issuance. At the next annual meeting the Company will be requesting shareholders to approve the maximum number of shares issuable under its stock option plan. Effective February 4, 2002, 363,000 employee share options were re-priced at $1.50 per option.

(e) Normal course issuer bid

The Company received approval from CDNX, which continued under the TSX, to repurchase up to 594,215 Common shares at the market price at the time of acquisition beginning December 20, 2001 and ending December 19, 2002. During the year, a total of 394,632 Common shares were purchased and cancelled at an average cost of $2.00 per Common share. The aggregate cost of the Common shares purchased and cancelled was $789,777 of which $575,601 was recorded as a charge against share capital for the average carrying value of the common shares, with the balance of $214,176 charged against retained earnings. The Normal Course Issuer Bid was renewed on December 20, 2002 until December 19, 2003. The number of Common shares permitted to be purchased and cancelled under the current issuer bid is 1,015,540.

Notes to Consolidated Financial Statements

(f) Pro forma disclosure

The Company does not record compensation expense for stock options issued to employees in 2002, as disclosed in note 2(e). Had compensation expense been determined based on the fair value at the grant dates, the pro forma earnings and earnings per share for 2002 would be:

December 31		2002 (as reported)		2002 ProForma
Earnings	$	**2,174,013**	$	1,966,752
Earnings per share				
Basic	$	**0.13**	$	0.12
Diluted	$	**0.13**	$	0.12

The fair value of stock options was estimated using the Black-Scholes option-pricing model with the following assumptions: Dividend yield (NIL), expected volatility (0.24); risk-free interest rate (5%); and weighted average life of 4 years.

(g) Share Purchase Loans

In 2002, the Company advanced funds to two executive officers to assist with the acquisition of Company Common shares. The loans are due June 30, 2003, are unsecured, and are non-interest bearing.

9. Future Income Taxes

The Company has an effective tax rate, which differs from the expected Canadian income tax rate. The differences are as follows:

		2002		2001
Statutory tax rate		**39.25%**		42.49%
Computed expected tax provision	$	**1,656,230**	$	1,328,917
Increase (decrease) resulting from:				
Resource allowance		**(1,421,754)**		(983,166)
Crown charges		**1,871,915**		1,149,934
ARTC		**(191,830)**		(155,606)
Other		**131,119**		(19,529)
Provision for corporate taxes	$	**2,045,680**	$	1,320,550

The Company had the following tax pools available for deduction against future taxable income:

		2002		2001
Canadian Exploration expense	$	**5,489**	$	1,243
Canadian Development expense		**14,963**		6,294
Canadian Oil and gas property expense		**10,502**		8,630
Undepreciated capital costs		**19,379**		7,117
Non-capital losses		**2,777**		427
Unamortized share issue costs		**1,183**		2,313
Total tax pools available	$	**54,293**	$	26,024

Notes to Consolidated Financial Statements

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. The components of the Company's future income tax assets and liabilities are as follows:

	2002	2001
Net book value of capital assets in excess of tax pools	$ (9,752)	$ (5,046)
Tax loss carry forwards recognized	1,179	983
Site restoration	594	191
Share issue costs	502	182
Alberta royalty deduction	276	113
	$ (7,201)	$ (3,577)

The Company paid large corporations taxes of $47,708 in 2002 (2001 - $Nil).

10. Commitments and Contingencies

(a) Operating commitments

In order to ensure continued availability of, and access to facilities and services to meet its operational requirements, the Company has entered into non-cancelable operating leases for office space and other property and equipment. Under contracts existing at December 31, 2002, future minimum amounts payable under these leases and agreements are as follows:

2003	$ 775,577
2004	751,881
2005	667,737
2006	286,345
	$ 2,481,540

(b) Commodity marketing arrangements

The Company has a price risk management program whereby the commodity price associated with a portion of its future production is fixed. The forward and futures contracts are subject to market risk from fluctuating commodity prices and exchange rates.

As at February 7, 2003, the Company had fixed the price applicable to future production as follows:

Expiry Date	Commodity	Type of Contract	Quantity Hedged	Hedged Price
April 30, 2003	Oil	Financial (costless collar)	350 Bbl /day	WTI $25.00 U.S. floor; WTI $29.80 U.S. ceiling
April 30, 2003	Oil	Financial (costless collar)	1,000 Bbl /day	WTI $23.10 U.S. floor; WTI $25.42 U.S. ceiling
October 31, 2003	Natural Gas	Physical	1,000 G.J. per day	AECO $5.07 per G.J. (Effective May 1, 2003 - $5.03 per G.J.)
October 31, 2003	Natural Gas	Physical	1,500 G.J. per day	AECO $5.15 per G.J. (Effective May 1, 2003 - $5.03 per G.J.)

Notes to Consolidated Financial Statements

(c) Liberty acquisition

As discussed in the Note 3, the finalization of the purchase price has not occurred. Management believes that by issuing the Common shares and providing cash and an irrevocable Letter of Guarantee totaling $6,811,425 to the Monitor, Lexxor substantially fulfilled its obligations with respect to the Arrangement. Subsequent to closing, management is disputing the proposed distribution of cash received by Liberty during the CCAA period. Any adjustment to the purchase price from this dispute will be accounted for as a purchase price adjustment in the period that the adjustment is finalized.

11. Financial Instruments

As disclosed in note 2(c), the Company holds various forms of financial instruments. The estimated fair value of recognized financial instruments have been determined based on the Company's assessment of available market information and appropriate valuation methodologies; however, these estimates may not necessarily be indicative of the amounts that could be realized or settled in a future market transaction. The fair values of these financial instruments approximate their carrying amounts. The nature of these instruments and the Company's operations expose the Company to interest rate risk and industry credit risk. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

(a) Interest rate risk management

The Company's borrowings are subject to floating rates. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates.

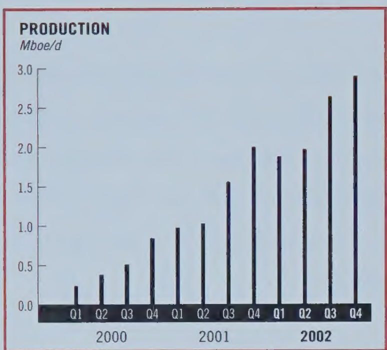
(b) Industry risks

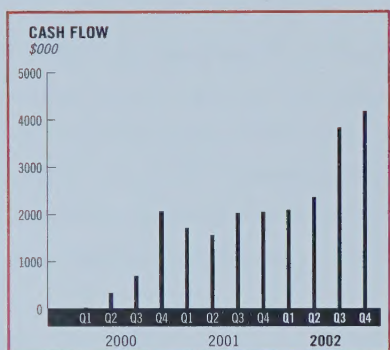
The Company's trade accounts receivable are from companies in the oil and gas industry, and as such the Company is exposed to all the risks associated with that industry. The Company manages price risk on its production by entering into forward sales and fixed price contracts (note 10(b)).

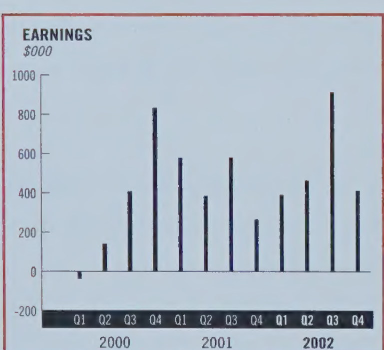
12. Comparative Figures

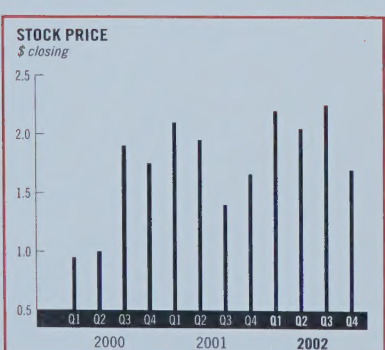
Certain comparative figures have been reclassified to conform to the current year's financial statement presentation.

2002 Quarterly Summaries









		Q1	Q2	Q3	Q4	**Year 2002**
Financial						
Oil and gas revenues		4,899	6,108	8,170	9,288	**28,465**
Cash flow from operations		2,090	2,360	3,824	4,181	**12,455**
Per share - diluted		0.15	0.16	0.20	0.20	**0.73**
Earnings		390	463	911	411	**2,174**
Per share - diluted		0.03	0.03	0.05	0.02	**0.13**
Net capital additions		4,942	3,628	28,133	3,970	**40,673**
Bank debt and working capital deficiency		19,176	15,163	34,130	30,081	**30,081**
Operating						
Production						
Oil and NGLs (Bbls/d)		1,628	1,632	2,051	1,966	**1,825**
Natural gas (Mcf/d)		1,525	2,031	3,550	5,601	**3,189**
Oil equivalent (Boe/d)		1,882	1,971	2,643	2,900	**2,357**
Average selling price						
Oil and NGLs ($/Bbl)		30.30	36.47	36.81	37.02	**35.89**
Natural gas ($/Mcf)		3.35	4.23	3.75	6.03	**4.54**
Oil equivalent ($/Boe)		28.92	34.55	33.61	36.75	**33.94**
BOE Netbacks	Operating	16.81	19.89	18.88	19.28	**18.77**
	Cash	12.16	13.50	15.79	15.82	**14.40**
Wells Drilled	Development	3	14	2	5	**24**
	Exploratory	8	1	3	6	**18**
	Total	11	15	5	11	**42**

		Q1	Q2	Q3	Q4	2001
Financial						
Oil and gas revenues		3,643	3,517	4,753	4,449	16,362
Cash flow from operations		1,708	1,559	2,026	2,052	7,345
Per share – diluted		0.15	0.15	0.19	0.17	0.66
Earnings (loss)		578	384	579	266	1,807
Per share – diluted		0.05	0.05	0.05	0.02	0.16
Net capital additions		6,505	5,854	3,911	8,630	24,900
Bank debt and working capital deficiency		8,786	12,145	12,889	16,216	16,216
Operating						
Production						
Oil and NGLs (Bbls/d)		592	750	1,220	1,684	1,065
Natural gas (Mcf/d)		2,305	1,663	2,058	1,910	1,983
Oil equivalent (Boe/d)		976	1,028	1,563	2,002	1,395
Average selling price						
Oil and NGLS ($/Bbl)		37.73	37.54	36.54	25.23	32.37
Natural gas ($/Mcf)		7.87	6.36	3.44	3.08	5.30
Oil equivalent ($/Boe)		41.47	37.61	33.05	24.16	32.24
BOE Netbacks	Operating	23.99	19.84	18.31	13.65	18.06
	Cash	18.40	15.46	13.38	11.00	13.94
Wells Drilled	Development	5	6	19	6	36
	Exploratory	2	2	3	0	7
	Total	7	8	22	6	43

Corporate Information

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ABBREVIATIONS

$M	thousands of dollars
/d	per day
ARTC	Alberta Royalty Tax Credit
Bbls	barrels
Boe	barrels of oil equivalent (1)
Bbl	barrels of oil
MBbls	thousand barrels
MBoe	thousand barrels of oil equivalent (1)
Mcf	thousand cubic feet
MMcf	million cubic feet
MStb	thousand stock tank barrels
NGLs	natural gas liquids
(1)	Natural gas is equated to oil on the basis of 6 Mcf of natural gas = 1 barrel of oil equivalent (Boe)

Directors

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Calgary, Alberta

Douglas O. McNichol (2)
Calgary, Alberta

Larry Nachshen (3)
Beaconsfield, Quebec

John Niedermaier (1) (2)
Calgary, Alberta

Carl Ravinsky
Westmount, Quebec

Ronald J. Will (1) (2)
Calgary, Alberta

(1) *Audit Committee*
(2) *Compensation Committee*
(1) *Chairman of the Board*

Officers

Douglas O. McNichol
President & CEO

Alan R. Bamsey
Vice President, Engineering and Operations

Thomas N. Cotter
Corporate Secretary

B. Cameron Dawes
Vice President, Exploration

J. Paul Lawrence
Vice President, Finance & CFO

Dwight T. Ostrosser
Vice President, Land

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National Bank of Canada
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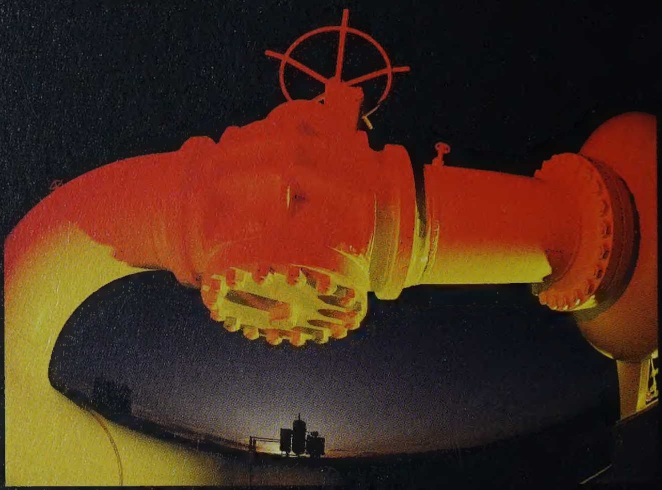
Stock Exchange Listing

Toronto Stock Exchange
Trading Symbol: **LXX**

LEXXOR ENERGY INC.



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